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100.0000 ADVERTISING AGENCIES, COMMERCIAL ARTISTS AND DESIGNERS—Regulation 1540
See also Printing and Related Arts; Service Enterprises Generally.
(Note: Prior to considering the following annotations, the status of the Advertising Agency acting as a seller, agent of client or as nonagent should be determined in accordance with Regulation 1540.)

(a) IN GENERAL

100.0010 **Advertisements in the Form of Sketches.** Sales tax applies to retail sales of ''spec ads,'' to a client which are produced prior to the sale of advertising space, even though the advertisements may be only in the form of sketches. Tax also applies to the purchase of tangible personal property used in producing the product that is sold. Only tangible personal property purchased for the purpose of being incorporated into the advertisement may be acquired without the payment of tax. 3/4/93.

100.0015 **Advertising Agency Acting as Agent.** An advertising agency entered into a written agreement with its clients indicating the advertising agency was the agent of the client. The agreement also provided for the agency to transfer title to all property to the client after each job was done. The agency issued resale certificates to its vendors and then marked up its cost when billing its clients on such jobs.

Under these facts, the advertising agency may have generally acted as an agent for its client by acquiring property from suppliers with a disclosed client and agency status, but it acted in a contradictory way by issuing its own resale certificate to vendors and marking up its cost when billing its clients. Also, title to these materials passed to customers when agency physically delivered them to the customer for review and approval.

Therefore, the full amount charged to the client for sales of tangible personal property is subject to sales tax, including charges for ''preliminary art.'' Since title passed to the preliminary art, it does not meet the definition of preliminary art contained in Regulation 1540(b)(4)(A). 12/31/93.

ADVERTISING AGENCIES, ETC. (Contd.)

100.0016 **Advertising Agency Acting as Agent.** Many advertising agencies estimate the purchases they make on behalf of their clients and bill their clients for the estimated cost of these purchases. If the advertising agency bills the client an amount including tax that is more than the amount of the invoice from the vendor to the advertising agency, is the amount in excess of the actual cost considered as a mark-up of the price for the tangible personal property that it transfers to its client? If so, under what circumstances is the advertising agency considered as the agent for its clients?

In order to qualify as an agent making purchases on behalf of its client, the advertising agency must disclose the price charged by the vendor. Sales and Use Tax Regulation 1540(c)(2)(C) explains that when an advertising agency invoices its client for tangible personal property provided by the advertising agency without separately stating the amount paid to the supplier for that property, the advertising agency is the retailer of the tangible personal property sold to its client.

When the vendor delivers the tangible personal property and then issues its invoice to the advertising agency, the operation of subdivision (c)(2)(C) is avoided by simply issuing a ''final'' bill to the client that separately states the amount paid by the advertising agency to the vendor. If the excess of the estimated price versus the actual price is credited back to the client, the vendor is considered to be acting as an agent and the advertising agency will have made the purchase on behalf of its client. If the overcharge is not disclosed by the advertising agency, then subdivision (c)(2)(C) will apply to make the advertising agency the retailer. The billing of the estimated cost for the tangible personal property is not the factor that makes the advertising agency the retailer in the transaction, rather, it is the failure of the advertising agency to separately state for its client the amount billed by the vendor. 4/22/03. (2004–1).

100.0030 **Art Incorporated Into Printed Sales Message.** Where an agency contracts to sell camera-ready art as well as a sale of a printed sales message, tax applies to the total gross receipts of the sale of camera-ready art including charges for consultation and research and charges for supervision related solely to the production of camera-ready art.

If the contract is solely for printed sales messages which qualify for the exemption under Regulation 1541.5, none of the charges for consultation, research or supervision are subject to tax. 10/14/93.

100.0030.800 **Artwork and/or Negatives Sold to Lessor.** When artwork and/or negatives are sold to a lessor without payment of sales tax, the lease by the lessor to a lessee would be subject to the tax.

If the lessor desires to pay tax on its acquisition and thus avoid tax on the lease transaction, the measure of tax with respect to the acquisition would include all amounts required to be paid by the lessor, including the amount paid for any reproduction rights. 12/12/90.

100.0031 **Artwork Transferred by Modem.** When artwork is transferred by modem, tax does not apply regardless of the reason for using this method of transmission. The artist must retain some form of evidence to support the claim

ADVERTISING AGENCIES, ETC. (Contd.)

of transmittal by modem. It is immaterial that under federal copyright law the buyer may be regarded as the owner of copyright interest in the artwork prior to transmission. 5/31/94.

100.0032 **Artwork Shipped Outside the State.** An artist sells and leases her artwork to persons who reproduce it on prints, posters and jigsaw puzzles. Typically, a copy of the original artwork in the form of a photograph or transparency is furnished to the buyer. The buyers are all located outside California. The artist is required to ship the photographs or transparencies to the buyer at the buyer's out-of-state location.

While the sale of the artwork would be taxable if delivery were made to the buyer in California, these sales are exempt sales in interstate or foreign commerce. 2/24/94.

100.0032.250 **Evidence Artwork was Transferred by Modem.** The transfer of artwork by remote telecommunications, such as modems, is not a sale of tangible personal property. Thus, tax does not apply to charges for artwork that is transferred by modem. The advertising agency must retain some form of evidence to support the claim of transmittal by modem. Such evidence could include the acknowledgment of receipt indicating the recipient's receipt of the artwork by modem. It is also suggested that the seller, advertising agency, state on the invoice that delivery was by modem and retain a hard copy of the artwork with a dated notation of the electronic delivery. 1/28/97.

100.0032.700 **Lease and Sublease of Intermediate Products.** An advertising agency leases photographs and illustrations from photographers for use as manufacturing aids to produce finished art. The advertising agency's use of a title passage clause in its contracts with clients is inappropriate when it uses the leased photographs in preparing property it sells to its clients because, by leasing the photographs and illustrations from photographers, the advertising agency does not have title to the photograph to pass to client.

If the advertising agency acts as an agent to its client under Regulation 1540(a)(2)(A), it may lease the photographs and illustrations from the photographer on behalf of the clients. In that case, the agency should pay use tax to the lessor on behalf of the client. The agency's reimbursement for the lease should be listed and priced separately from the agency's charge for the final product.

An advertising agency who wishes not to act as an agent on behalf of the client but rather to sublease the property to the client may timely pay use tax to the photographer (lessor) and, prior to making any use of the property, lease the property to the client in substantially the same form as acquired. If it does so, its sublease to the client is not taxable. The advertising agency may alternatively issue a resale certificate to the lessor and, prior to making any use of the property, sublease the property to the client, collecting use tax from the client on that sublease. In the latter event, the advertising agency's sublease of the property is subject to use tax regardless that the agency's sale of the final product to the client is exempt from tax (i.e., sales in interstate commerce) or is a nontaxable

sale for resale. When the advertising agency acts as the seller, the following clause between the agency and its clients would be acceptable evidence that the property was subleased to the client prior to use by the advertising agency:

"It is expressly understood that, when the agency leases from lessors intermediate products, such as photographs and illustrations, the agency subleases such property to you prior to any use by the agency whether or not the agency transfers possession of the property to you. Any use of the leased property by the agency is on your behalf." 7/17/97.

100.0032.875 **Licensing Agent—Providing Artwork.** A taxpayer is a licensing agent for owners of certain intellectual property rights such as cartoon characters (properties). Under the various license agreements with the owners of the properties, the taxpayer's art department agrees to provide artwork incorporating the properties for use by licensees. Under the agreements, all uses of the properties by third party licensees shall insure to the benefit of the owner. The taxpayer shall not have any interest or property rights in any of the properties. Under the various licensing agreements (except one), the taxpayer receives a licensing fee of 40% of the gross receipts paid by licensees. In the one exception, the taxpayer will receive a five percent increase in the royalty payments if its art department provides any artwork.

Under the contracts with the owner of the properties, the taxpayer is providing both a service and a sale of tangible personal property (artwork). Since the taxpayer provides a variety of services to the owner for a fee and does not separately state a charge for the artwork, the portion of the fee attributable to the sale of artwork is subject to tax on the fair retail selling price of such property. (Regulation 1540(b)(2)(C).)

In the case where there is a five percent increase in the licensing agent fees when artwork is provided, the increased amount is consideration for the transfer of the artwork and, therefore, it is the measure subject to sales tax. 2/28/95. (Am. 2004–1).

100.0033 **Management Fee.** An advertising agency entered into a contract to provide advertising materials. It was not designated as an agent of the client. The contract provided that the agency was to pay all bills incurred in the advertising program and the client was to reimburse it monthly for those costs plus the sum of $2800 which was designated as the monthly guaranteed compensation for the term agreement.

The agency was the retailer of the advertising material which it furnished under this contract. The $2800 "guaranteed compensation" was a part of its gross receipts. Therefore, it should be pro-rated between the sales of taxable tangible personal property and non-taxable sales (i.e., printed sales messages) in order to determine the appropriate measure of tax. 4/16/91.

100.0034 **News Releases and Copywriting.** A public relations firm which writes news releases and writes the words for brochures, but does not provide artwork or printing is not engaged in the type of activities that require the holding of a seller's permit. 8/19/88.

ADVERTISING AGENCIES, ETC. (Contd.)

100.0034.200 **Outdoor Displays and Projected Images.** A taxpayer is in the business of producing outdoor displays featuring graphics which combine traditional printed outdoor displays and projected images. The images are projected using techniques that include stills, slides, motion pictures, interactive computer projections and light shows. The graphics may be projected onto billboards or onto architectural surfaces, such as buildings, walls, bridges, etc. The taxpayer creates and produces the graphics and may arrange for the lease of the equipment needed for the displays.

The tax consequences of the different circumstances involved in outdoor events are as follows:

(1) Programmed lighting. This is the use of automated stage lighting to produce theatrical effects. Custom computer program may be used to vary the direction, intensity, and sequence of the lights used. Some projections may include a projected logo or other graphic images. ‘‘Gobos’’ may be inserted into light sources to project desired images. A gobo is defined as a glass or metal stencil made by lasers and created from artwork (e.g., logo sheets). Computer programs control the light source so that the projected images can appear to move and change.

If the computer program to control the light show qualifies as a custom program under Regulation 1502(f)(2), the charges for its sale or lease are not taxable.

With respect to the gobos projection method, the taxpayer produces finished art for the client, such as a logo or other graphic image, but a third party makes the gobo, using the finished art. Tax applies to the taxpayer’s charges to its client for finished art produced by the taxpayer (Regulation 1540(b)(4)(B)). If the gobos, special printing aids, or manufacturing aids are acquired from third parties by the taxpayer as its client’s agent within the meaning of Regulation 1540(a)(2)(A), the third person supplier is the retailer of the property to the taxpayer’s client and the taxable transaction is that sale.

Also, the taxpayer may act as an agent on behalf of its client in dealing with third persons in acquiring for sale or lease of any equipment, such as lights, trucks, generators, electronic equipment, etc., needed for the light show.

(2) Projected still images. Still images may be projected by a slide projector, a motion picture projector, or a computer projector.

If the taxpayer acts as a seller or produces the finished slide films in-house, the taxpayer is the photographer and sales tax applies to the sales price of the slides to the client. The sales price does not include expenses which are not a part of the gross receipts from the sale of the slides. Since the lease of the projection equipment, generators, and other tangible personal property needed to set up and project the slides is unrelated to the production of the slides sold, these charges are excluded from the gross receipts from the sale of the slides unless the lease is required as condition of the contract of sale of the slides.

If the taxpayer acquires the finished slides from an outside photographer and acts as its client’s agent, tax applies as stated in item (1) above. The

reimbursement for property acquired as an agent for the client should be separately invoiced or shown separately on an invoice to the client. (Regulation 1540(a)(2)(A).)

(3) Printed image with projection motion. This display divides an outdoor display into two sections. Fifty percent of the display is a printed image, e.g., printed onto a billboard. Fifty percent of the display is a projected motion picture, e.g., projected onto the same billboard.

In this situation, the printed image portion of the display is treated separately from the projected motion portion. Regulation 1540 governs the application of tax to the printed image portion. The application of tax to the projected motion portion of the display is governed by Regulation 1529. If the projected motion meets the definition of ''qualified motion picture'' in Regulation 1529(b)(1), the charge for the projected motion would not be taxable. However, charges for release prints are taxable when sold to a person for exhibition or broadcast.

(4) Projected still images with printed motion. This is an outdoor display that splits the display into two sections. Fifty percent is motion picture, while fifty percent is a projected still image.

The application of tax to slide projection is covered under item (2) above. However, if the stills are projected by means of a motion picture projector, e.g., continuous loops of motion picture film or tape, the stills would then be considered the same as a motion picture and Regulation 1529 would govern the application of the tax.

(5) Interactive Motion. This method uses a computer and projection equipment to project live computer output onto an outdoor display.

See response to item (1) above with respect to custom computer programs and the sale or lease of computers, projectors, and other equipment needed for the display. 12/18/95.

100.0034.275 **Paste-Up Work on Customer's Premises.** Charges by a self-employed graphic artist for work on a customer's premises to paste up a catalog to make it camera-ready are included in gross receipts since a fabrication labor type of sale took place. 9/26/90.

100.0034.310 **Postcard Advertising.** An advertising firm offers advertising for its clients by placing postcards in restaurants. If a restaurant agrees, a rack is installed by the advertising firm and the restaurant gets its own postcard printed free of charge to be placed in one slot in the rack. Postcards are provided free of charge to patrons. The advertising firm furnishes the postcards, places them, and refills the rack. The clients are billed monthly for the advertising. Title to the postcards remains with the advertising firm.

The advertising firm does not sell the postcards to its clients since title to the postcards remains with the advertising firm. The advertising firm provides an advertising service to its clients and places its own postcards in the restaurants for the restaurant patrons to take free of charge. The advertising firm is a consumer of the postcards and the racks in which the postcards are placed. 1/18/95.

ADVERTISING AGENCIES, ETC. (Contd.)

100.0034.360 **Press Check.** A graphic designer enters into a contract with a client that provides for the fabrication and sale of final art. The client enters into a separate contract with a printer for the actual printing of the printed matter. Upon completion of the final art by the designer, the designer delivers the final art to the printer, or to the client for redelivery to the printer.

The designer also agrees to perform a service for the client it calls "press check." This service consists of the designer approving the print run prior to the completion of the full order to insure that the final output is optimal in terms of color and shading. The designer in no way directs or supervises the manner in which the printer obtains the optimal results sought by the customer. The designer charges the client, not the printer, an hourly rate for providing this service. The press check is not a required process in the completion of the printed material and is offered as an optional service by the designer for the convenience of the client. The client may purchase the final art without also purchasing press check services.

Since the designer does not perform or supervise fabrication, its press check services do not constitute sales under subdivision (b) or (f) of section 6006. Thus, the charges for the services would generally be taxable only if the client would not purchase the final art without also purchasing the press check. Since the press check is optional and unrelated to the sale of the artwork, it is not part of the sale of the final art and the designer's charges for the press check are not taxable. 11/5/96.

100.0034.400 **Producing a Print Advertisement.** A taxpayer who is a design and marketing company contracts to create and produce an advertisement for print media. The taxpayer's concept of the advertisement is shown to the client in the form of visual presentations. The concept's visual presentations include photographs, illustrations, and written advertising headlines. The visual presentations may be physically mounted on boards or may be in the form of "output from the computer" which includes text and graphics generated by a computer program and printed out in the form of hard copy so that the client can view it. Neither title to, nor possession of, the tangible personal property which is used in preparing or displaying the visual presentations passes to the client.

After the client selects a preferred concept, the taxpayer develops the concept further through a writing and graphic design process. Prior to production, the taxpayer prepares a final mock up for the client's review and approval. After the client's approval, the taxpayer produces, on a computer, camera ready artwork and type which it transmits via a computer disk to be reproduced or duplicated in-house by a photographic process. This photographic reproduction is then shipped by the taxpayer to the publication which will run the advertisement. The publication in which the ad will run is not a printed sales message as defined by Regulation 1541.5. The taxpayer is not acting as an agent on behalf of the client.

When the taxpayer produces a print advertisement for a charge, it is the seller of tangible personal property (such as photographic reproduction of the ad) sold at retail to the client. However, tax would not apply to the taxpayer's separately stated charges for preliminary art, such as the visual presentations and/or

mock-up which taxpayer shows to the client to obtain final approval for production of the final ad. Tax does apply to the total amount of the charges to the client for the production of the finished art and photographic reproduction of the ad following client approval of the preliminary art. 11/19/96.

100.0035 **Service or Sale.** Taxpayer produces and distributes an annual catalog of over 100,000 periodicals, newspapers, annuals, etc., to public, corporate, and academic libraries, who are the taxpayer's potential customers. Customers desiring to buy or subscribe to publications listed in the catalog place their orders with taxpayer, who then places orders with the appropriate publishers. The merchandise is shipped directly to customers by publishers and the taxpayer is billed by the publisher. Taxpayer bills the customers for the standard cost of the merchandise plus a service charge. Any ancillary charges or credits originating with the publishers, such as discounts or sales taxes, are passed on to the customer by the taxpayer.

Based on these facts, the transactions do not result in the performance of a service, but rather are purchases on the taxpayer's own behalf, for resale to its customers, unless it can be clearly established that it is acting as an agent of a customer in any given acquisition. To establish the existence of an agency relationship, the taxpayer must inform the publisher of the name of the client for whom the purchase is being made; must previously obtain written evidence of the agency relationship; bill the client for the same price as billed by the publisher, and may not issue a resale certificate. 12/19/91.

100.0036 **Sales of Layouts.** An advertising agency has entered into contracts with its clients. The contracts contain different clauses pertaining to terms of payments and termination. These clauses have a direct effect on whether there are sales of layouts to customers. The contracts fall into three groups:

(1) Clauses in these contracts state that upon termination, all property and materials in possession of the agency and paid for by the client will be transferred to the client. All rejected or unused advertising plans and ideas will remain the property of the agency.

Under contracts which contain clauses with this language, it is clear that title passes to the customer on all approved layouts and all rejected or unused plans remain the agency's property. Also, there are provisions in these contracts which state that once the property is approved and paid for the property belongs to the client. Accordingly, even though there was no transfer of possession, there was transfer of title and a sale occurs at the time of payment.

(2) Clauses in these contracts state that all work done by the agency for the client shall become the exclusive property of the client upon payment therefor. Following termination of agreement, the agency shall transfer to the client all material, etc., subject only to the client's payment to the agency therefor.

Under these types of contracts, the client has the right to all work done by the agency upon payment of the agreed upon price. All work includes preliminary layouts and thus, tax applies to charges made for layouts at the time of payment.

ADVERTISING AGENCIES, ETC. (Contd.)

(3) Clauses in these contracts state that all plans for advertising, layouts, etc., shall become, from time of approval, the client's exclusive property. Title shall be contingent upon full payment by the client within the time provided in the agreement. Upon termination, the agency agrees to transfer and make available all property and materials in the agency's possession.

Under this type of contract, a sale has taken place on layouts that are approved and paid for. If the termination of the contract occurs before a layout is approved and paid for, the sale occurs on the termination date. 7/8/81.

100.0037 **Sale—Transfer Via Modem.** The transfer of illustrations to a client via modem for a fee licensing their use is neither a sale nor a lease as there has been no transfer of tangible personal property. The fact that the illustrations could have been transferred on disc or on paper during the illustrator's routine visits to the client is irrelevant as neither alternative was taken. 3/11/94.

100.0037.300 **Transfer of Artwork by Artist Via Computer.** An artist prepares artwork and places it on the artist's removable computer storage media (e.g., floppy disk). The artist takes the disk to the customer's location, inserts the disk into the customer's computer, and transfers the artwork from the artist's disk to the customer's computer. The artist removes the disk and retains it, and does not otherwise provide any tangible personal property to the customer. The transfer is not a sale of tangible personal property provided the artist retains title to and possession of the disk at all times. For example, if, after inserting the disk and prior to its removal, the artist leaves the computer and the customer uses it, the artist would be regarded as making a taxable lease of the disk. 7/22/96.

100.0037.400 **Transfer of Artwork into Computer's Memory.** A graphic artist completes artwork on his computer and copies the artwork onto a digital storage file format such as ''zip, syquest, floppy disc (or via internet).'' The graphic artist transfers the file to the customer's premises and transfers the file of digital information into the customer's computer memory. The graphic artist then removes the original disk, which remains in his possession at all times. The copied file on the customer's computer would then become the customer's property. The customer may then manufacture tangible, hard copy prints of the file.

Where the graphic artist actually operates the customer's computer equipment to transfer the artwork into the computer's memory and maintains sole control over the customer's computer during this process, there is no transfer of tangible personal property to the customer. Therefore, the graphic artist's charge would not be subject to sales tax. However, if the graphic artist transfers the artwork to the customer in any tangible form such as printed copies or diskettes, tax applies to the charge. 5/14/97.

100.0038 **Charges to Agencies.** Except in the case of a ''loaned employee,'' freelance artists, copy writers, production supervisors, art directors, etc., who are hired by agencies to supplement the agencies' own staff are regarded as retailers of tangible personal property which they fabricate unless the agency sells the property prior to making any use of it.

ADVERTISING AGENCIES, ETC. (Contd.)

''Employee'' generally means a person who is on the payroll of the agency. A ''loaned'' person may be regarded as an ''employee'' if (1) the person is an employee of a lender, (2) the borrower/customer provides the tools, equipment, raw materials, and premises at which the work is done, (3) the charge is an hourly rate, (4) the borrower has other persons who are clearly employees performing similar work or a person who is capable of giving meaningful direction to the loaned employee beyond describing the result desired, and (5) the borrower, not the lender, must supervise the loaned employee. 5/5/94.

100.0039 **Fund Raising Consultant.** A firm creates printed materials for use by nonprofit organizations in fund raising. It does consulting, research, copywriting, and project coordination. It subcontracts other work to graphic designers, printers, photographers, and others. All of these items are billed separately to the client.

Tax applies to the various charges as follows:

(1) The charge for ''consulting and research'' is subject to tax as services that are part of the sale of the printed matter.

(2) The charge for copywriting is subject to tax since the copy is written solely for use in the printed matter to be sold.

(3) The charge for graphic design is subject to tax. Charges for ''preliminary art'' which is clearly identified on the billing are exempt if the requirements for ''preliminary art'' as described in Regulation 1540 are met.

(4) Charges for writing a cover letter to be sent with the solicitation material are subject to tax.

(5) Tax does not apply to charges for addressing envelopes. 1/10/85.

(b) DELINEATORS AND DESIGNERS

100.0054 **Calligraphy, etc.** Calligraphy is hand lettering and it is taxable as artwork pursuant to Regulation 1540 except when addressing for mailing. Addressing for mailing is nontaxable whether done by hand, by a calligrapher, by a typewriter, by a computer, or by a calligraphy machine. Addressing for other purposes, such as an inside address on a letter, which does not show through the window of an envelope, is taxable regardless of the method used.

One-of-a-kind art pieces created for a client, signs, and camera ready art are all taxable when sold at retail in this state. 7/1/91.

100.0060 **Caricatures.** Where an artist is hired by the hour by agencies for their clients, or by individual companies to draw caricatures at an event, a taxable sale of tangible personal property occurs and the entire amount paid to the artist is includable in gross receipts.

The artist transfers title and possession of the caricatures by giving them to the individuals at the events attended. Consideration received is in the form of money from the agency or firm which contracts with the artist to draw the caricatures. It is immaterial that the total consideration paid for each caricature varies, depending upon how many drawing requests the artist receives during an event. Although part of the payment received for selling caricatures may represent

payment for the artist's attendance at the event and drawing of the caricatures, the sales price includes the full payment received by the artist, not just the value of the ink, paper, and drawing which the artist sells.

Where the artist is hired by the hour, regardless of whether a single caricature is drawn, and the artist attends an event at which a caricature is not drawn, the payment the artist receives is nontaxable. 3/15/91.

(Note: This opinion was superseded by section 6010.30, operative April 1, 2000.) (Am 2000–2).

100.0071 **Comprehensive Pencil Layouts—Independent Contractor.** A commercial artist prepares comprehensive pencil layouts for a telephone company's yellow pages. The artist creates penciled work sketches using paper, borders, and other fabrication materials provided by the telephone company. The artist provides her own pencils and also some supplies used on the layouts. The artist prepares the artwork at her residence and works at her convenience as long as the assigned work is completed by a stated deadline. No invoicing occurs. The work is priced by unit, and pricing is based on layout size and the estimated time required to complete a rough layout. All prices are determined by the telephone company and the artist can accept or reject any work assignment.

Under these facts, the artist is self employed and not an employee. The artist has exclusive discretion to self determine her day to day business activity and practices, and her ability to accept or decline projects. Both the artist and telephone company are free to terminate their relationship at the end of each contract.

Because the artist is an independent contractor and not an employee of the telephone company, her transactions constitute sales of tangible personal property and the amount received is taxable gross receipts. 5/22/91.

100.0073 **Design Consultant.** An individual, who describes his/her operation as a design consultant, provides its customers with ideas in how their products should look, feel and function. A large part of the work pertains to appearance and characteristics of the specific products. The ideas are usually conveyed through sketches, renderings or drawings. Sometimes a 3-dimensional study model is used to accurately convey the final color, finish, texture, feel or tactile quality of the concept.

Based upon the description of this business, the individual is a commercial artist or designer, not a design consultant who provides only services. Although some services are almost always necessary in the creation and manufacturer of commercial products and sales tax may be charged on the mass produced item when sold at retail, sales tax nevertheless applies to the transfer of those items which the client uses to manufacture other products. 2/13/91.

100.0074 **Design Copy Furnished to Clients.** A commercial artist performs design work for clients. The original art or designs are retained and copies are furnished to clients for use in newspaper advertisements. The entire charge is taxable regardless of the fact that only a copy of the artwork is furnished to the customer. 3/27/95.

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100.0074.080 **Design of Retail Store Interior.** A design and marketing company (DMC) has a contract to design the interior layout of a store and its interior fixtures. The contract also provides that DMC will design and develop the store's display fixtures, including Point of Sale Graphics and Interior signage relating to the product that will be sold in the store.

The work DMC will perform for the client is as follows:

Step One: ''Client Consultation.'' Attend meetings and verbally present creative concepts to client.

Step Two: ''Creative Concept.'' Depict the concepts in tangible form as visual presentations mounted on boards. These include ''conceptual illustrations, computer-generated visual materials incorporating typography, photography and illustrations.'' These items will be presented out in the form of hard copy for client review. These designs will be rough at this point and will be modified many times. Neither title to, nor possession of, these designs will pass to the client.

Step Three: ''Finished Drawings.'' These will be the final drawings and/or diagrams of the interior layout of the store, and final drawings of interior store display fixtures and other interior fixtures. These drawings will be transferred to or used by the client in making the fixtures and placing them in the proper location in the store.

Step Four: ''Finished mock-up and final artwork.'' This will consist of final visual representations of the interior signs, including dimensions, artwork, typography, color and other details. These will serve as a guide during the making of the signs. DMC will also make example models, usually to the exact size and scale of the signage. The models will also be used as a guide during the making of the completed signs. The final artwork, embodied in a computer, will be transferred to the client.

Step Five: ''Installation.'' DMC is responsible for placing and, if needed, fastening and adjusting the fixtures in the store in the proper locations and configurations. No fabrication or assembly of fixtures will be performed at the store site, and the installers will be employees of DMC.

Step Six: ''Training.'' DMC will train employees of the client to properly set up and maintain the interior store system and plan designed by DMC. This training is not required by DMC but is an optional element which the client chose to include in the contract.

Since it is only the sale or use of tangible personal property which is subject to tax under the Sales and Use Tax Law, where there is no transfer of title or possession to tangible personal property, the transaction is not subject to tax. In Step One (''Client Consultation'') and Step Two (''Creative Concepts'') there is no transfer of title or possession of any tangible personal property from DMC to the client. Under the particular facts of this transaction, the services performed in these two steps are not considered to be a part of the sale of tangible personal property by DMC. Rather, these charges are for professional services for interior decorating. Thus, charges in Steps One and Two, including charges for travel cost, are not subject to tax. However, these charges should be separately stated in DMC's billing to the client.

ADVERTISING AGENCIES, ETC. (Contd.)

Since the final drawings of the fixture in Step Three are used as a reference or guide in making the fixture, they are final art or production drawings. Tax applies to the total charges made by DMC to the client for the finished drawings (including any related travel costs). Charges for any other final drawings provided to the client, or to a third party for the benefit of the client, are also subject to tax, excluding separately-stated charges for preliminary art as defined in Regulation 1540.

In Step Four, the final visual representations and mock-ups/example models are created to serve as a guide during the making of the completed signs by the third party vendors. Likewise, the computer disk which contains final artwork for the signs is fabricated by DMC to be used for actual reproduction in making the signs. The sales of the final visual representations, mock-ups, and computer disks by DMC to the client are retail sales of finished art which are subject to tax. Tax applies to the total charges made by DMC for that finished art, including any charges for the cost of travel. If any preliminary art is physically incorporated into the finished art, charges for such preliminary art are subject to tax as well.

In Step Five, DMC is responsible for installing the fixtures. Charges for the labor or service of installing tangible personal property are not subject to tax. Thus, DMC's charges for installation of the client's fixture, as well as any charges for travel costs related to the installation, are not subject to tax. However, these charges should be separately stated in the contract or billing to the client.

In Step Six, the training provided by DMC as a service which is an optional part of the agreement with the client is not a part of any sale of tangible personal property by DMC to the client. Charges for that training, including any charges for travel costs are not includable in DMC's taxable gross receipts. However, these charges should be separately stated in DMC's billing to the client. 12/20/96.

100.0074.100 **Design of a Television News Set.** A taxpayer contracted to design a news set for a television station. Under the contract the taxpayer will perform two functions. One function is titled, ''Design/Consulting Service,'' which includes preliminary drawings and 3-D drawings of the approved design concept. The contract provides reimbursement for per diem, mileage and other expenses associated with the completion of the contract. The other function is titled ''News Set—Move to New Studio,'' which includes consultation to facilitate moving the news set, design consultation to select colors and wall coverings, charges for a ''install tech,'' and per diem for the ''install tech.''

Under the ''Design/Consulting Service'' function of the contract, sales tax applies to the entire amount charged for drawings, paintings, designs or sketches transferred to the customer. Tax does not apply to charges for preliminary art if the charges are separately stated and meet the requirements of Regulation 1540(b)(4)(A). Taxable gross receipts also include charges for all expenses incurred including travel expenses and cost of blueprints used. However, a resale certificate may be issued to purchase blueprints from other vendors which are resold to the customer.

If the function titled ''News Set—Move to New Studio'' is optional, that is, the customer can purchase the first function which involves the sale of tangible

personal property without also purchasing the second function, then the charge is not a service that is part of the sale of tangible personal property. In that case, sales tax does not apply to the taxpayer's charge for those separately stated consultation charges. 6/30/95.

100.0074.500 **Designing Advertisements.** Clients send the taxpayer pencil outlines of a proposed advertisement. The taxpayer buys camera work for line art and spec and typesetting. She designs the ad and sends proofs to the client. Subsequently, she buys color composite film which is sent to a magazine in which the ad will appear.

Tax applies to the charge for designing and developing the ad in the form of the color composite film. Those items which are physically incorporated into the color composite film may be purchased for resale. Items such as photographs which are not physically incorporated into the color composite film cannot be purchased for resale. 5/16/88.

100.0085 **Pencil Sketches.** The transfer of a pencil sketch to a customer who uses it as an ''idea'' for a wood sign is the transfer of tangible personal property and is subject to tax. 8/1/90.

100.0100 **Renderings—Unique Drawings.** An artist who provides a firm with unique architectural renderings purchased for the purpose of resale must obtain a permit since ordinarily such purchases would constitute retail sales taxable to the artist. 1/4/65.

100.0103 **Signs and Graphics Services.** A taxpayer is a graphic design company, with a contract to provide signs and graphic services at a medical center. The taxpayer will provide graphic design (artwork) as well as architectural services. There are four phases to the contract and each phase must be completed and approved by the client before continuing to the next phase. The total fee will vary depending on the time it takes to complete each phase.

Phase I is a review of the client's design themes and to come up with conceptual ideas. Phase II is the ''Preliminary Art'' stage where sketches and rough design drawings are rendered. No title will pass on any work for Phase I and II.

Phase III will be for finished art. This will include the construction documents that consist of finished artwork and final blueprints. Phase IV will be for quality control supervision to observe the installation of the finished art, including the construction documents. No design or artwork is provided in Phase IV. Another company will provide the final blueprints and install the items at the site.

In Phase I and II, the taxpayer is regarded as preparing preliminary art. Tax will not apply to amounts billed under these two phases if the preliminary artwork is not physically incorporated into the finished artwork.

Phase III requires the taxpayer to provide finished artwork of the designs as well as final design drawings for use in the construction of finished signs. Under this phase, the taxpayer is providing either finished artwork and/or production drawings. As such, sales tax applies to the sale of these items.

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A portion of the charges under Phase IV are regarded as attributable to the supervision and review of installation by a third party and are excludable from taxable gross receipts. However, under Phase IV, the taxpayer is also required to review and revise (as necessary) the fabricator's shop drawings. The taxpayer's charges under Phase IV, that relate to or contribute to the design or production of the finished signage, are taxable as part of the cost of producing tangible personal property sold to its clients. (Section 6012(a).) 4/14/95.

(c) PRELIMINARY AND FINISHED ART
Reproduction proofs, see Printing and Related Arts.

100.0104.800 **Art Used in Packaging Containers.** A company, selling computer based training materials on diskettes, contracted with a designer to create a new design for the cover of the packages in which the diskette and manuals are sold. This design was used to create camera-ready art which was photographed. The printing plates used to print the packaging were created from the negative film. The company maintains that the art design cost is part of the packaging cost of the product sold and thus should be exempt from sales tax.

The fact that the art purchased was not camera ready art does not affect the taxability of the sale. The preliminary art exclusion from sales and use tax is not applicable here because the artwork was sold to the company pursuant to the contract to deliver art work. Presumably title passed to the company upon sale, after which the company made use of the design to produce its packaging. The exemption for sales of containers also is inapplicable to this case. The design purchased by the company is not a container or a component part of a container, but rather is used in fabricating the container. 10/24/89.

100.0111 **Catalog Layouts.** A commercial artist designs catalog page layouts in the form of rough sketches for a client. He keeps the original and gives copies to the copywriter, typographer, photographer, and paste-up person, each of whom is under separate contract with the client. The copies are not returned to the artist. The sketches do not qualify as preliminary art because they are not prepared to demonstrate ideas to the client before the finished art is prepared. The sketches are the finished art. The transfer of possession of the copies for a consideration is a sale for sales and use tax purposes. 11/17/82.

100.0113 **Charges for Ad-Prep.** An advertising agency contracts to provide advertising services consisting of placement of advertising in printed media. The agency does not have an agreement with its customers authorizing the agency to purchase property as an agent on behalf of the customer.

In providing its services, the agency purchases photographs, artwork, art supplies, copywriting, typesetting supplies, and other items used to produce mechanical paste-ups. Photostats of the mechanicals are furnished to the print media. When the mechanical is of no further use, it is delivered to the client or destroyed.

The client is billed separately for placing the ad and an "ad prep" charge representing the cost of preparing the ad material (materials, outside labor and fabrication labor).

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If the ad agency merely prepares and delivers the mechanical to the media on the agency's own behalf, tax would not apply to the charge for the mechanical. The ad agency would be the consumer of tangible personal property used in preparing the mechanical. However, when the mechanical is delivered to the client or title to the mechanical passes to the client, the ad agency is the retailer and tax applies whether the charge is separately stated or not. 6/20/86.

100.0115 **Charges for Graphic Design.** A graphic designer is responsible for producing the layout of a newsletter for which the client contracts separately for the printing. During the course of the graphic designer's work, meetings are held with the copywriter, printer and client to go over layout options and ideas for additional art. The printer is under contract with the client.

Tax applies to the total charge for the layout including the portion of the charge attributable to the meetings. 11/21/91.

100.0118 **Computer Created Graphic Design.** A taxpayer, a graphic designer, gives her client an estimate for the job, including her charge for all the time and material she needs to complete the ad layout. When the client approves the estimate, she prepares sketches, but does not show the sketches to the client; rather, she selects which sketches she will use to proceed to the next step. On her computer, she creates a page design that incorporates her ideas into two or three layouts. She laser prints the two or three layouts to present to the client. The client suggests changes which she incorporates. She then works on the original idea page to create the next step in the process, art which is presented to the client who may make additional changes. After making the changes, taxpayer prepares the final art and provides it to the client on a disk.

When the taxpayer provides the final art to the client in the form of tangible personal property in this state, whether the final art is on paper or computer disk, the charge is subject to sales tax. However, the taxpayer may exclude from the measure of tax separately stated charges for preliminary art even when it is prepared on a computer. The taxpayer's nontaxable preliminary art charges might include charges for the sketches, the meetings attended prior to obtaining approval to proceed to finished art, the time spent on the photo shoot, and research time. Hard copy of each of the roughs, visualizations, layouts, or comprehensives presented for client's approval should be retained for audit purposes. 6/3/97.

100.0120 **Computer Created Preliminary Art.** Charges for "preliminary art" created through the use of computers are not taxable provided the criteria of Regulation 1540(b)(4)(a) are followed. The seller must retain proof of the client's ordering or the artist producing the preliminary art prior to the date of the contract for finished art and the charge for preliminary art must be separately stated. Hard copy of each of the roughs, visualizations, layouts or comprehensives which are presented for the client's approval must be retained for audit purposes. 5/27/93.

100.0125 **Concept Design of Stage Sets.** A company is responsible for the concept design and follow through to the finished project of stage presentations. This includes the scenery, stage rigging, etc. The following specific sales are made by the company.

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(1) The services provided by the company include conceptual design, drafting, floor plans, lighting design, and blueprints.

The charge for such design is taxable according to Sales and Use Tax Regulation 1540(c). However, tax does not apply to separate charges for preliminary art as defined in (b)(4)(a).

(2) The company designs and produces the item designed.

The charge for producing and designing the item is subject to tax.

(3) Company makes a retail sale of designs or scenery. Charges include services such as production management, site labor, site survey and miscellaneous services.

Tax applies to the entire gross receipts of the sale with no deduction for charges for the various items listed.

(4) Company constructs a ''tech platform'' for the client and removes the platform after production.

Tax applies to the charge for the platform. 10/23/91.

100.0129 **Acceptance of Preliminary Art.** In order to show that art qualifies as nontaxable preliminary art, it is not necessary that there be separate contracts for preliminary art and for finished art. Acceptance of preliminary art may be made either before a contract is entered into for the production of finished art or before the client (with a contract already entered into) authorizes the agency to prepare the finished art. 4/12/94.

100.0130 **"Design Time."** In the absence a client's purchase orders or an artist's work orders to prove that the artist's clients ordered, or the artist produced ''preliminary art,'' the billing description ''Design Time'' in connection with the preparation of mechanicals and camera ready art is not sufficient to identify the time as being for preliminary art as there is no evidence that preliminary art was prepared prior to approval of the finished art. The situation is not corrected by merely relabeling the charge as preliminary art. 2/8/83.

100.0145 **Mechanical Artwork.** A designer is hired by a client as an independent contractor to design and produce mechanical artwork for a variety of printed materials. Their agreement includes a title clause stating that title to all items purchased is transferred to the client at the time of purchase and prior to usage by the designer.

The designer prepares two or three preliminary designs (preliminary art) for presentation. Once the client chooses a design, the client owns the design. The designer purchases items, such as photography, illustrations, etc., under his or her resale certificate, without sales tax reimbursement, to complete the design selected. The designer then charges for these costs on the invoice to the client along with sales tax reimbursement. Under these circumstances, the designer may properly purchase the photography, illustrations, etc., under a resale certificate. When a preliminary design (preliminary art) is not chosen by the client, the designer retains title to and possession of the designs, and provides no

tangible personal property to the client, then tax does not apply to the charge to the client for time spent on the project. Use tax is due from the designer on the purchase price of property used to prepare the rejected designs.

The designer may accept a resale certificate from an advertising agency or another design firm for the sale of the final product which will be sold by the ad agency or other design firm. On the other hand, the designer's sale of special printing aids, such as photography and illustrations, generally would be a retail sale subject to sales tax regardless that the sale of the final product is a nontaxable sale or resale.

The designer may accept a resale certificate for the sale of special printing aids, only if the advertising agency or other design firm **insists** that it is purchasing the property for resale. In such case, the designer should require the purchaser to provide a resale certificate containing a statement that the specific property is being purchased for resale in the regular course of business. 6/30/92.

100.0158 **Packaging Design Transfer.** A taxpayer designed packaging for various types of products. By agreement with its clients, the taxpayer developed and presented to its clients a selection of preliminary package design concepts which were done at the taxpayer's expense and at no cost to the clients. Upon acceptance of the design by the client, the client obtained the exclusive right, title and ownership interest to the design concepts prepared by the taxpayer. At all times it was contemplated the taxpayer would transfer title to the design concepts to the client. The client's true object was the obtaining of the preliminary design package. The transactions were therefore retail sales of tangible personal property. Even if the design package is viewed as preliminary art, tax applies because title to the design packages was passed to the clients. 2/15/95.

100.0159 **Preliminary Art.** In order to avoid tax on preliminary art, the work must be ordered before there was a contract or agreement or approval to produce the finished art. Accordingly, it is necessary for the agency commercial artist or designer to establish proof of ordering or producing preliminary art prior to the date of contract or approval of the final art. The mere designation of a separate charge for ''design'' and a charge for ''production'' is not sufficient proof. 6/22/93.

100.0160 **Preliminary Art.** A company enters one or more concepts into a computer and gives the client a laser print proof of the layout(s). Whichever layout is chosen is refined and proofed (with laser print-outs) until it is ''perfect''. At that time, the company obtains signed final approval to have it printed on a high resolution printer. When a designer uses a computer to prepare art, the designer must abide by the provisions of the regulation in order to consider any part of the charge nontaxable preliminary art. The designer produces a rough design in physical form which could be identified as preliminary art when the ''laser print proof'' of the layout is produced. The taxpayer should have the client initial and date approval of that design or have other similar evidence to show that the proofs were produced prior to the date of the contract or approval for finished art. 12/14/92.

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100.0161 **Preliminary Art.** A company issues separate purchase commitments for preliminary art and finished art. The company proposes an amendment to the ''Additional Terms and Conditions'' of the purchase commitment. The proposed amendment states that the vendor agrees that all the materials prepared pursuant hereto shall be owned exclusively and in perpetuity by the company, and vendor hereby irrevocably assigns to the company any and all of its right, title and interest, including copyright, prior to any use by vendor in and to such materials. Exception: the above does not apply to conceptual/creative art (herein referred to as 'Preliminary art'). . . .''

The amendment to terms and conditions is necessary for the vendor of the art to comply with the preliminary art provisions of Regulation 1540. Other criteria must also be met, i.e., the transfer of possession roughs, visualizations or other forms of preliminary art can only be temporary for review purposes only, before the vendor may exclude the charge for preliminary art from the taxable charge for final art. 11/4/92.

100.0162 **Preliminary Art.** A designer produces various types of artwork which include discussion of concepts, preliminary roughs, finished artwork and photo retouch. Some customers use the artwork to produce t-shirts, brochures, etc., and charge their customers for artwork, film, and the final product. The designer's customer generally is the consumer of artwork and tax applies to the sale.

If the client's contract with its customer provides that title to artwork passes prior to use, the designer may accept a resale certificate but should require the customer to include a statement that the specific property is being purchased for resale in the regular course of business. Provided that the resale certificate was taken in good faith, tax will not apply to the sale of the artwork. 8/31/92.

100.0163 **Preliminary Art.** Preliminary art is not taxable under certain conditions. One of the conditions is that title to the preliminary art must not pass to the client. If the preparer of the preliminary art gives possession of it to clients for purposes of review, the preparer must require the client to return the artwork. This is true even if the preparer intends to destroy the art immediately. 2/14/95.

100.0164 **Preliminary Art.** In order to avoid tax on preliminary art, it is not necessary that the specific term ''preliminary art'' appears on the invoice as long as the description is sufficiently clear and all of the requirements of Regulation 1540 for exclusion from tax are met. 11/3/94.

100.0168 **Purchased Material Incorporated in Finished Art.** As provided by Regulation 1540(a)(2)(B), advertising agencies are not agents of their clients with respect to the acquisition of materials which become physically incorporated into items of tangible personal property prepared by their own employees. Therefore, advertising agencies are retailers of purchased photographs, artwork, and typography which become physically incorporated into finished art produced by the agency's employees.

On the other hand, they may be agents acquiring property not incorporated into the finished art if the agencies purchase the photographs, artwork, etc., as agents

and use them as manufacturing aids. Charges by the advertising agency for these manufacturing aids and the related agency fees are not part of the ‘‘gross receipts’’ from the sale of the finished art. 5/16/77.

100.0170. **Purpose of Preliminary Art.** A disk containing computer generated preliminary art, after being shown to and approved by the client, is sent to the typesetter who uses the disk to drive the typesetting machine. Under these circumstances, the contents of the disk do not qualify as preliminary art as they were not created ‘‘solely for the purpose of demonstrating an idea or message for acceptance by the client’’, as required by in Regulation 1540(b)(4)(A). 8/24/90.

100.0180 **Rough Sketch.** A preliminary sketch does not become ‘‘physically incorporated’’ into the finished art when the rough sketch is used to trace the outline of the art work to a separate water color board which is the finished art. The preliminary art work does not become ‘‘physically incorporated’’ unless it is actually touched up or finished and physically delivered to the customer as the finished art. 12/20/65.

100.0185 **Sales of Illustrations Through an Agent.** An illustrator obtains jobs through an artist’s representative who acts as her agent. The representative obtains jobs for the illustrator and bills the clients. The representative retains a commission out of the payments received from the clients.

If the representative acts as an agent, both in obtaining jobs and billing the clients, the illustrator is responsible for tax on the full amount paid by the clients to the agent. Since the illustrator is the retailer, she is liable for the sales tax and the representative/agent should transmit the sales tax reimbursement collected from clients to the illustrator.

The representative should not pay tax directly to the Board unless the representative has issued a resale certificate to the illustrator (i.e., the representative is not acting as an agent). 12/7/93.

100.0187 **Sketches as Finished Art.** A commercial artist designs catalog page layouts in the form of rough sketches for a department store. The artist keeps the original sketches and gives copies of the sketches to the copywriter, typographer, photographer, and paste-up person to use in designing and preparing the final advertisement. Each person is under separate contract with the department store. The copies are not returned to the artist.

The artist’s transfer of possession of the sketches or copies of the sketches, for a consideration, is a sale. The sketches do not qualify as preliminary art because the artist does not prepare the sketches solely to demonstrate an idea to the department store for approval before the artist prepares finished art. Rather, the sketches are the artist’s finished art. 11/17/82.

100.0190 **Title Clause.** An agreement between an advertising agency and its customer includes a title clause that states ‘‘all advertisements, copy, and layouts which are prepared shall become client’s property and shall be preserved for delivery to client upon request’’ is sufficient to include preliminary art. This is true even though preliminary art is not specifically mentioned. Under Regulation

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1540(b)(4)(A) ''preliminary art'' includes layouts. It is reasonable to interpret the contract as passing title to all ''preliminary art,'' particularly when ''preliminary art'' is not excluded from the title provisions any where else in the contract.

Therefore, the separately stated charges for preliminary art are subject to sales tax even though the preliminary art does not become physically incorporated into the finished art. 2/28/95.

100.0193 **Transfers of Artwork.** A commercial artist who is an independent contractor contracts with a company for purposes of preparing layouts of proposed ads. The artist will get an idea from the customer of what they would like in the ad. The artist will prepare a proposed layout for such an ad. If the customer is not happy with the ad, everything stops and no further action is taken. If the customer is satisfied, the layout is completed and put in a form acceptable for advertising. Upon acceptance by the customer, the layout is forwarded by the company to their ad agency. Upon receipt by the ad agency, they redo the mock-up and will typically use a computer for preparation of the fine artwork. At this point, the layout prepared by the artist is simply thrown away. The question is whether these visualizations and layouts are nontaxable as ''preliminary art.''

Regulation 1540 provides the basis for nontaxable preliminary art. However, it specifically limits when the tax will not apply. One such requirement is that the finished art is to be furnished by the agency, commercial artist, or designer who prepared the original art. This artist merely provides artwork but never provides any finished art. In all situations, the work done by the artist is taken by the company to its ad agency for preparation of finished art. Since the artist does not supply the finished art, the visualizations and layouts cannot meet the definition of ''preliminary art,'' and the artist's gross receipts are subject to tax. 10/5/92.

100.0195 **Tracing the Final Drawing.** After preliminary art (sketches) has been approved by a client, a separate piece of paper is placed over the preliminary art and the final drawing is traced in ink.

Assuming that the preliminary art satisfies all of the necessary criteria and that it is truly preliminary art (i.e. is a rough or visualization and does not have the detail of finished art), the charge for preliminary art is nontaxable regardless that it is then used by placing a separate piece of paper over it to trace the final drawing in ink.

However, an artist cannot produce finished art in this fashion, without seeking an interim approval from the client, and consider only the charge for labor of tracing as subject to sales tax. In this case, the product is not ''preliminary art'' because it is not produced solely for the purpose of obtaining approval from the customer. 6/30/92.

100.0197 **Transfer of Artwork on Disc.** Computer generated preliminary art may be nontaxable if, for example, an artist created five different concepts on a disc and presented the designs to a client for approval. The client chooses one design and the artist recreates the design on another disc. If the artist follows the procedures in Regulation 1540(b)(4)(A), the artist may consider the charge for

preliminary art nontaxable. The artist must retain the medium containing the design as well as records to prove the client ordered, or the artist produced the preliminary art prior to the date of the contract on approval for the finished art.

The transfer of artwork on a disc is not considered to be a transfer of a custom program. The transfer of the output is subject to tax. Tax applies to the entire charge for the artwork, including any portion of the charge attributable to programming by the retailer for their use in producing the artwork. 3/17/92.

100.0198 **Transfer of Finished Art to Third Party.** Taxpayer is engaged in the graphic design business and produces finished art in the form of paste-ups for its clients. Taxpayer delivers a high quality photograph of the paste-up to a printer selected either by the taxpayer or the client. In either case, the client deals directly with the printer, and the printer's charges are not reflected on taxpayer invoices. The printer then reproduces the item desired by the client, (e.g., advertisements and annual reports). In some cases, the taxpayer claimed to have retained title to the finished art and high quality photographs.

Regulation 1540(a)(1) specifically provides that advertising agencies are "sellers of any of the property, . . . they deliver to, or cause to be delivered to, . . . third parties for the benefit of their client." Accordingly, taxpayer's temporary transfer of possession to various printers of the finished art constituted taxable "sales" (leases) under section 6006(g), and taxpayer was responsible for collecting use tax from its clients measured by the lease payments, (i.e., the consideration clients paid for taxpayer's service in the production of the finished art).

With respect to transactions in which taxpayer explicitly transferred title to its client, taxpayer was the retailer of the finished art and is liable for sales tax measured by its gross receipts. 10/11/83.

100.0200 **Typography—Paste-ups.** Typography expenses billed to clients of advertising agencies for reproduction proofs used in paste-ups are subject to tax. Paste-ups are finished art work produced for use of the client and are taxable. 12/21/65.

100.0220 **Typography—Paste-ups.** Advertising agencies and commercial artists are retailers of paste-ups which they produce and sell to others for use in the production of printed matter. When copy is produced by means of the Varityper and is physically incorporated into such a paste-up, the entire charge for the paste-up, including the portion of the charge attributable to the copy, is subject to tax. 5/11/67.

100.0250 **Where Preliminary Art is Found Taxable.** Company contracts to write, design and print a brochure for the State of California. Charges made to the state include "preliminary art."

Tax applies to the total sale price of the printed brochures with no deduction for the charge for preliminary art. "Preliminary Art" is taxable because it is not

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required to be prepared before entering into the contract or before obtaining approval of the finished art. Sales and Use Tax Regulation 1540(b)(4)(A). 10/21/91.

100.0251 **Preliminary Art.** The requirement in Regulation 1540 that ''preliminary art'' must be clearly identified on the billing as preliminary art does not mean it must be designated as ''preliminary.'' Suitable terms such as ''roughs,'' ''visualizations,'' ''layouts,'' ''comprehensives,'' ''concept art,'' etc., which are descriptions of the preliminary art will suffice. 1/21/77.

(d) PROPERTY TRANSFERRED OR USED

100.0280 **Advertising Agency as Consumer—Lump Sum Billings.** An advertising agency is the consumer of property that it uses prior to sale to a client. For example, if the agency purchases artwork for resale, photographs the artwork, and incorporate the photograph into an assembly, the agency has made a taxable use of the artwork. In such case, tax applies to the sale of the artwork to the agency. Tax would also apply if the agency later sold the artwork to the client. The agency may not purchase such property under a resale certificate unless it sells the property to the client prior to its use of the property.

Substantiating that property was sold to a client prior to use would require an explicit written agreement with the client, prior to the agency's use of the property, transferring title to the property to the client prior to such use. 8/28/81.

100.0292 **Advertising Agency—In-House Art Department.** Tax applies to charges for finished art produced by an advertising agency's own art department, even though it has a true agency contract with the client. Charges for typography and copy written solely for inclusion in the finished art and any mark-up thereon would be included in the measure of tax. 10/14/75.

100.0300 **Advertising Agency as Nonagent.** An advertising agency is the seller of reproduction art work prepared by its own art department for the preparation of pamphlets, etc. Section 2295 of the Civil Code provides: ''An agency is one who represents another, called the principal, in dealings with third persons.'' An advertising agent in the preparation of art work for its client is not dealing with third persons and, accordingly, cannot act as an agent with respect to that activity. 3/11/58.

100.0304 **Artwork.** When an ad agency develops artwork for a client that will be used in reproducing the image on the packaging of software which is to be resold, the sale of the artwork is subject to sales tax. (Regulation 1540(b)(4)(B)).

On the other hand, when the ad agency only prepares the artwork for its own use and contracts with the client only to sell the packaging, the total charge for the sale of the packaging to the client is exempt as a sale of a nonreturnable container. (Regulation 1589(b)(1)(A).) 5/27/93.

100.0305 **Artwork Reproduced on Packaging.** Artwork is sold by an advertising agency to a client and the client transfers it to a printer for use in

reproducing the image on packaging. The advertising agency is making a taxable sale to the client because the sale of artwork for use by a client to advertise its product is a retail sale. 5/27/93.

100.0306 **Artwork Used for Reproduction Purposes.** A graphic designer who renders artwork and uses the photo mechanical transfer copy process to copy artwork for its client is making a use of the artwork. Thus, tax applies to the cost of such artwork to the graphic designer. If the graphic designer produced the artwork, tax is due only on the cost of the materials (ink, paint, illustration board, etc.,) consumed in producing the artwork.

However, such artwork would be sold prior to use if, before the graphic designer uses the artwork, the graphic designer and client enter into an explicit agreement that title to the artwork will pass to the client before such use. The intention to transfer title prior to the use of the artwork should be clearly expressed in writing constituting a part of the contract sale entered into prior to use of the artwork. 3/10/82.

100.0308 **Campaign Literature.** A company is in the business of handling political campaigns for candidates and issues in California election contests. A contract is signed indicating that the company is an agent in the purchase of brochures and other materials. The company provides consulting and planning services in setting up the campaign and deals with the printer in the procurement of brochures and mailing pieces. The company prepares preliminary art, some final mechanical art, and some computer design which is used in the production of brochures. When brochures are finished the company bills the candidate for the brochures separately than for other consulting services, but does not usually specify on the invoice the exact printer's charge nor does it routinely show the markup separately.

The company claims that the true object of the contract is the performance of consultant services, that the value of simple artwork done by the in-house artist is minimal, and that elaborate productions are handled by outside suppliers of art and mechanicals who charge sales tax. The company also provides creative concept copyrighting and graphic design with in-house staff for other direct-mail-product-only accounts and understands that there are ''printed sales messages'' which are exempt from tax.

Apparently the company, by signing a contract ''indicating that the company is an agent'', wishes to avail itself of the procedure provided in Regulation 1540(a)(2)(A) to act as agent for the client. Since the company both marks up the cost of the brochures and does not separately invoice the reimbursement for purchasing the property, it does not acquire the brochures as an agent on behalf of the candidate. The company makes a taxable sale of the brochure and artwork to the client.

The true object of the contract is not the performance of consulting services. The artwork or brochures are custom made properties and have value as items of tangible personal property, the sale of which is subject to sales tax. The sales of

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he brochures are not exempt sales of printed sales messages. ''Campaign literature and other fund-raising materials'' are specifically excluded from the term ''printed sales messages.'' 4/15/92.

100.0309 **Concept Development.** A charge for writing copy, (e.g. an outline of the points to cover in final copy, etc.) which will be incorporated as part of tangible personal property, may be excluded from the taxable measure as nontaxable author services if the advertising agency or designer follows the criteria of Regulation 1543(b)(4) which sets out the necessary terms of the contract and the standard of proof which are necessary for the exclusion to apply. 3/31/93.

100.0310 **Copy Writing Solely for Media Advertising.** Charges for copy written solely for media (television, radio, newspaper, etc.) advertising messages or for more than one purpose, one of which is for media advertising messages, are not taxable. Such charges must be separately stated from taxable charges. Therefore, if the agency contracts to furnish the client with both the mechanical and the placement of the advertising, the agency's separately stated charge for writing the copy is excludable from the gross receipts of the sale of the mechanical. 3/27/87.

100.0320 **Copy Writing Used in Media Advertising.** If an agency only sells a mechanical to a client and does not contract to furnish the media advertising, the taxable gross receipts of the sale of the mechanical include the charge for the copy writing. In such cases, the agency's charge is for ''copy written solely for use as a part of tangible personal property as to which the agency is acting as a seller.'' (Regulation 1540(b)(4)(E).) The client's furnishing the mechanical to the media does not make the charge for the copy nontaxable. 3/27/87.

100.0328 **Cutouts.** Tax applies to an advertising agency's charge for cutouts. Cutouts are a type of special order merchandise produced to the order of the advertising customer. While possession of the cutout is retained by the advertising agency, it has been concluded that they are used solely for the benefit of the advertising customer and are sold within the meaning of section 6006(f). The utilization of the cutout on behalf of the customer is considered to be comparable to drawings, lettering, special assemblies, etc., produced for clients by advertising agencies in the course of providing advertising services. Such items are classified as sales under Regulation 1540(b). Cutouts are distinguishable from sign copy because cutouts are painted and displayed on reusable panels owned and retained by the advertising agency. 8/11/71.

100.0340 **Engravings for Out-of-State Periodicals.** Advertising agencies are consumers of engravings produced for them for use in fulfilling advertising contracts with customers. When the advertising is to be placed in a periodical published outside California, and the contract requires the engraver to send the finished engraving directly to the publisher, the sale is in interstate commerce and exempt. The furnishing of the customary number of proofs for the purposes of inspection and approval will not affect the exemption. If a substantial number of

proofs are printed pursuant to orders of the agency or the customer and are used for purposes other than inspection and approval, the charge for the engravings is subject to tax. 12/4/68.

100.0355 **Mechanical Assembly Purchased from Outside Source.** If an advertising agency contracts to sell printed material to a client, the agency cannot avoid paying sales tax on the sale by merely obtaining the actual assembly of the paste-up or mechanical as an agent for the client. 1/24/84.

100.0360 **Modeling Fees.** An advertising agency which entered into contracts with an advertiser and with a model (both independent contractors) is the retailer of the photographs which it furnishes to its clients. The taxable retail selling price of the photographs includes the photographer's charges for taking the photographs and the model's fee. 9/22/67; 11/13/67.

100.0450 **News Releases Prepared by Client.** A client of an ad agency prepares its own news releases. The agency does not edit, rewrite or modify the releases. The agency submits the news release to a printer. The client is billed for the agency's services on a hourly bases and for the cost of the printing plus an agency commission.

If the ad agency establishes that it has acquired the printing as an agent for the client under the requirements of Regulation 1540, tax does not apply to the advertising agency's charges for its services. 1/9/85.

100.0660 **Stock Photographs.** An advertising agency obtains a license for a one-time use of a photograph. Printed material which includes copies of the photograph is sold to the client. The photograph itself may not be purchased for resale by the advertising agency since it is not physically incorporated into the product which is sold. 6/16/94.

100.0760 **Transfer of Mechanical Paste-Up.** A firm transfers a mechanical paste-up it produces to a client. The firm retains title to the paste-up but the client has the right to use the paste-up for reproduction purposes. The gross receipts from the transfer of possession of the paste-up are subject to tax as the sale of tangible personal property. 9/27/73.

100.0900 **Writing Advertising Copy.** Writing advertising copy is generally a non-taxable service. A charge for writing copy that is obtained by an advertising agency, as an agent of the client, is nontaxable. However, tangible personal property that is sold at retail is taxable and includes, in the taxable gross receipts, the charge for writing copy as part of the selling price of that property. 8/24/90.

ADVERTISING MATERIALS
See Gifts, Marketing Aids, Premiums and Prizes.

ADVERTISING SPACE
Sale of, see Tangible and Intangible Property.

AERIAL PHOTOGRAPHS AND MAPS
See Photographers, Photostat Producers, Photo Finishers and X-Ray Laboratories.

AGENCY FEE
See Advertising Agencies, Commercial Artists and Designers.

AGENTS
Forwarding, see Interstate and Foreign Commerce.

AIDS
Manufacturing, see Property Used in Manufacturing.
Marketing, see Gifts, Marketing Aids, Premiums and Prizes.

AIR
See Gas, Electricity and Water.

105.0000 AIRCRAFT—Regulation 1593
See also Demonstration, Display and Accommodation Loans of Property Held for Resale; Use of Property in State and Use Tax Generally; Vehicles, Vessels, and Aircraft.

105.0005 **Aircraft and Gliders.** A taxpayer, who operates a glide port, purchased two tow planes (single engine aircraft) and seven gliders. The aircraft and gliders will be used solely in the operation of the glide port. Members of the general public pay a fee for a glide ride.

The tow planes are not being used as common carriers of property or persons. The tow planes are being used to tow property owned by the taxpayer and are subject to tax. The gliders are not powered contrivances and, therefore, are not aircraft as defined in Section 6274. Since the gliders are not aircraft, the exemption under Section 6366 for aircraft sold to common carriers does not apply to the sales of the gliders. As such, the purchases of the gliders are also subject to tax. If purchased ex-tax by certifying in writing to the sellers that the aircraft and gliders would be used for exempt purposes, per section 6421 the purchaser must pay sales tax measured by his/her cost of the property, as if they were the retailer making a retail sale of the aircraft and gliders. 4/8/92.

105.0009 **Aircraft—Purchaser Liable for Sales Tax.** A dealer regarded its sale of an aircraft to a nonresident of California to be exempt from sales tax based on a certificate in the form prescribed by subdivision (e) of Regulation 1593 issued by the nonresident purchaser. This exemption applies to a purchase of an aircraft by a nonresident of California who will not use the aircraft in this state other than to remove the aircraft from California. Since the purchaser certified to the dealer that the aircraft would be used in a manner entitling the dealer to regard the sale as exempt, the purchaser is liable for sales tax if he uses the aircraft in some other manner or for some other purpose. (Reg. 1667 (b)(3)).

The aircraft was removed from this state, but was returned within 12 months for repairs and servicing. Subdivision (d)(1) of Regulation 1593 provides that the exemption is not affected if the aircraft is returned to California within 12 months from its removal, if the purpose is solely for repair or service covered by

warranty. Accordingly, if the aircraft returned to California solely for repair or service covered by warranty, the exemption will not be affected by the presence of the aircraft in California for that purpose. However, if the aircraft returned to California for any other purpose, the exemption is forfeited and the nonresident purchaser owes sales tax on the sales price of the aircraft paid to the dealer. 8/30/01; 3/12/02. (Am. 2002–3).

105.0010 **Aircraft—Purchaser Liable for Sales Tax.** A purchaser of an aircraft gave an exemption certificate to a California aircraft dealer. In the certificate he claimed that he was a nonresident of California and that he would make no use of the aircraft here, other than its removal from the state. The purchaser owned real property in California, and Oregon and spent time in Oregon, California and Arizona. The purchaser filed California resident income tax returns, claimed a homeowners exemption on a residence located in California, and owned a vehicle licensed and registered in this state. The aircraft was flown to Oregon on the date of purchase and did not reenter California until it was put up for sale two years later.

Since the aircraft was delivered in California it is a sales tax transaction. The seller was relieved of the liability for the tax due to the purchaser's issuance of an exemption certificate. The purchaser is not entitled to the exemption provided by Regulation 1593 (a)(3), since he was a California resident at the time of purchase. As the result of issuing an erroneous certificate, the buyer is liable for the sales tax on the purchase price of the aircraft, pursuant to Regulation 1667 (b)(3). 5/23/93.

105.0011 **Aircraft Sales by Nondealers.** The Federal Deposit Insurance Corporation (FDIC) is selling three aircraft which have been foreclosed and repossessed by FDIC acting as a receiver on behalf of Corporation A. Two of the aircraft are being sold to a Hong Kong corporation and the other will be sold to a Canadian airline. The drafted sales agreements for these aircraft provide that transfer of possession and title will occur at a California airport where they are currently stored. Employees or representatives of the respective purchasers will be responsible for piloting the aircraft to their intended destination.

Since the FDIC is not a dealer of aircraft, the applicable tax would be use tax, which is imposed on the purchaser. Because the aircraft are subject to the use tax, acceptance of delivery in California may not subject the purchase of the aircraft to use tax if the aircraft is transported outside the state for use solely outside California. 1/31/96.

105.0012 **Aircraft Test Flights.** Test flights of an aircraft purchased for the purpose of modification for high altitude parachute jumping do not qualify as ''non use'' of the aircraft pursuant to Regulation 1593(c) as that classification applies only to test flights of aircraft sold to common carriers, foreign governments, and nonresidents. The purchasers of this aircraft do not fall into any of these categories. Making the test flights is a taxable use. 5/30/86.

105.0013 **Air Taxi, Carriage of Aircraft Owner.** The purchaser of an aircraft leases it to a certified air taxi operator. Most of the subsequent air taxi billings by

the operator of the aircraft are to the owner. If the owner does not receive a preferential rate or some basis not available to the public at large, the carriage of the owner is regarded as common carriage. 7/25/94.

105.0018 **Air Taxi Operation—Repair Parts.** A taxpayer is an air taxi operator qualifying as a FAR Part 135 common carrier. In its ordinary course of business, the taxpayer leases an aircraft from the aircraft owner for use in its FAR 135 operations. As part of the management agreement, the taxpayer arranges maintenance and repairs required on the aircraft. The maintenance and repairs include labor and parts. In many cases, the actual maintenance and repair work is performed by companies located out of state. The taxpayer pays the company doing the repairs and then bills the aircraft owner for the maintenance and repair work performed. Upon completion of the repair/maintenance work, the aircraft is flown back into California to be used in the FAR 135 operation.

The exemption set forth in section 6366.1 applies only to complete aircraft, not aircraft parts. However, when the aircraft enters California after maintenance and repair work have taken place, the parts attached during the repair and maintenance work will have already been incorporated as an integral part of the aircraft. (*Pan American World Airways, Inc.* v. *State Board of Equalization,* and *Flying Tiger Line Inc.,* v. *State Board of Equalization*.) That is, when aircraft parts are installed onto aircraft outside California and first enter this state as part of the aircraft, the parts themselves are regarded as ''aircraft'' for purposes of section 6366.1.

Accordingly, if the taxpayer's air taxi operation actually uses the aircraft as a common carrier for more than one-half of the operational use of the aircraft during the 12-month test period, the taxpayer's principal use of the aircraft will be deemed to be that of a common carrier, and such use of the aircraft will be exempt from the sales or use tax. The test period for any part in question is the twelve-month period following that part's entry into California. Thus, even if the aircraft qualifies for the common carrier exemption, that does not mean that the use of the parts automatically qualifies. If the aircraft on which the parts installed is not used principally a common carrier during the twelve months following the parts first entry into this state, use tax applies to the use of that part in California. 6/19/95.

105.0040 **Charter Flights.** Whether a charter is involved depends solely on the degree of control retained by the owner. If possession and control of the property in question are not transferred to the purported lessee, then the transaction is not a lease. Rather, the purported lessor is actually using the property. Thus, if the aircraft owner will not ''lease'' the aircraft without providing a pilot who will maintain control of the aircraft during flight, then that flight is a charter and not a lease. Such an owner may not elect to pay tax on fair rental value because there is no lease and no rentals are paid. *Entremont* v. *Whitsell* (1939) 13 Cal.2d 290. 6/29/92.

105.0046 **Charter to Owner-Lessor.** A lessor-owner purchased an aircraft from an out-of-state seller and immediately entered into an ''Aircraft Lease and Usage Agreement (100% Lessee Usage).'' The agreement required the lessee (a

common carrier operator) to pay the lessor-owner rent of $505 per flight hour, and for lessor/owner to pay the lessee rent of $461 per flight hour. In addition, the lessor/owner was required to pay an agreed amount for pilot services, miscellaneous fees and expenses, if any, for those occasions when the lessor-owner rented the aircraft from the lessee.

The Board has held that a charter of an aircraft to an owner or lessor-owner of an aircraft is not ''common carriage'' when the owner receives a preferential rate on some basis not available to the general public (section 2170 of the Civil Code). The rate of $461 plus an agreed amount for pilot service and miscellaneous fees and expenses would not result in a price significantly different than the charge made to the general public. Although a rate not significantly less than that charged to the general public may not be considered as carriage use, such a conclusion would not end the analysis. The fact that the lessor-owner paid a separate amount for the pilot raises the issue of whether such carriage was pursuant to Part 135 of Title 14 of the Code of Federal Regulations and, thus, ''common carriage'' or pursuant to Part 91 of the Code and not ''common carriage.'' In a true ''common carriage'' agreement it is not customary for pilot services to be separately charged.

Also, Part 135 has more stringent rules (e.g., a written load manifest must be prepared prior to the flight and must be retained; certain operating equipment must be part of the aircraft, certain pre-flight briefings must be made to the passengers, and certain weather conditions cannot exist before the flight). Also federal excise tax is charged for such flights.

In this case, billings were not shown as revenue, but rather as a charge to ''owner'' and the term ''rents'' rather than ''charter'' was used. This implies that the lessee did not regard the flights as Part 135. Such a finding is also consistent with the agreement which required the lessor-owner to pay for pilot services. This is a strong indication that the lessor-owner had control over the aircraft. Accordingly, although the amount charged may not be a ''preferential rate,'' the aircraft when used by the owner was not used ''common carriage'' as discussed in Part 135. 9/26/95.

105.0059 **Common Carriage.** A company purchased and accepted delivery of an aircraft out of state on or about July 3, 1989, and flew it into California that same day. On August 1, 1989, the company leased the aircraft to a certified air carrier. The lease agreement required the company to pay for the pilot and other crew members when the aircraft was used in common carriage. To avoid these charges, the company allowed its president to serve as pilot as often as possible. During this period, the president passed FAA inspections and was certified as a common carrier pilot. During these flights, the president is under the lessee's direction and control. The issue is whether, during the ''operational use'' test period for this aircraft with the company's president as pilot, the flights would qualify as common carriage.

The undisputed evidence shows that the purpose of the flights was to carry passengers unrelated to the company. The passengers contracted with the lessee for carriage. The lessee billed the customers and the customers paid the lessee at

standard common carriage rates. Other than allowing its president to serve as pilot, the company did not participate in these transactions in any way. These flights cannot be considered private use by the company. 10/13/92.

105.0059.200 **Common Carriage—Banner Towing and Aerial Photography.** Although such operations may be carried on under the authority of the laws of the United States, banner towing and aerial photography do not constitute common carrier operations.

Once it has been established that the operator offers his services to the public indiscriminately, and has in fact carried the public on several flights, specific contracts with persons to haul them for specific periods will be considered common carriage. Not included in this category is the purchase of a particular plane for the specific purpose of entering into a long term carriage contract with a particular person. 10/31/75.

105.0060 **Common Carrier.** A company operating under an ''air taxi/commercial operator'' certificate issued by the Federal Aviation Administration, providing air transportation to the public in an aircraft under control of the company's pilot at a rate based on mileage plus standby and other charges, on a nonscheduled basis, is a common carrier within the meaning of Sections 6366 and 6366.1. 5/26/69.

105.0061 **Common Carrier.** The following discusses the application of tax to three scenarios involving the use of a helicopter for emergency medical transport with a hospital:

Scenario 1—A firm which owns a helicopter contracts directly with the patients for transportation services (ambulance service to hospitals) and bills and collects from them or their insurance carrier.

Assuming the transportation services are authorized under the FAA regulations governing the owner's FAA common carrier certificate, the common carrier exemption would apply if the other requirements of Regulation 1593 are satisfied.

Scenario 2—The hospital purchases a helicopter from a dealer and contracts with a firm to provide pilots, mechanics, parts, and other personnel and supplies necessary for the operation of the helicopter. The hospital will contract with the patients and will be responsible for billing and collecting fees from the patients or their insurance carriers. The firm will be paid a monthly fee and an additional fee for each operating hour.

In this case, it is the hospital that owns and uses the helicopters and contracts with customers for transportation services. Assuming the transportation services of the hospital are authorized under the FAA regulations governing the FAA common carrier certification under which the helicopter is operated, the common carrier exemption would apply if the other requirements of Regulation 1593 are satisfied.

Scenario 3—A firm purchases or leases a helicopter and then ''leases'' it to a hospital. The firm also contracts with the hospital to provide pilots, mechanics, parts, and other personnel and supplies necessary for the operation of the

helicopter. This may involve two contracts (one for the lease and one for the flight services) or a single contract. The hospital contracts with patients and is responsible for billing and collecting the applicable fees. The firm will be paid a monthly fee and an additional fee for each operating hour.

If the transaction between the firm and the hospital is a true lease, then the hospital is the person regarded as using the helicopter and the analysis applicable to the other scenarios are equally applicable here. That is, assuming the transportation services are authorized under the FAA regulations governing the FAA common carrier certificate under which the helicopter is operated, the common carrier exemption would apply if the other requirements of Regulation 1593 are satisfied.

However, if the firm is instead regarded as providing charter services to the hospital rather than leasing the helicopter, then the use of the helicopter would not qualify for the common carrier exemption. Whether a charter is involved depends on the degree of control retained by the firm. For example, if the firm will not lease the helicopter without also providing a pilot, then the firm is providing charter services and is not regarded as leasing the helicopter. The firm will not be offering services to the public or to some portion of the public, but, rather, offering its services to a single person, the hospital. 11/18/94.

105.0062 **Common Carrier.** The owner of an aircraft has an agreement with a common carrier and under the circumstances listed below the agreement was not a lease of the aircraft to a common carrier and therefore not exempt from tax under Regulation 1593(a)(1).

(1) The owner is required to pay all fixed, direct, and incidental costs incurred in operation and maintenance of the aircraft.

(2) All charter advertising was in the carrier's name, but the content of the advertisement was subject to the owner's approval, and paid for by the owner.

(3) The owner accounts to the carrier for all charter hours flown, and to submit to the carrier the completed flight logs within three days of each charter.

(4) The flight crew members, who are employed by the owner, have been directed by the owner to comply with the carrier's policies and procedures.

(5) The carrier needed advance approval from the owner to fly an actual charter for a third party customer.

The above circumstances and ensuing action effectively resulted in the aircraft and pilots being under the control of the owner and not the carrier. A common carrier qualifying under Regulation 1593, is the carrier who schedules and approves use of the aircraft, conducts the FAR Part 135 flights, controls the pilots and aircraft during those flights, prepares the Part 135 flight logs, and then accounts to the owner/lessor. In this situation, the owner's control of the aircraft negates any contention that the carrier had the exclusive possession and control of the aircraft necessary for the carrier to have conducted Part 135 carriage operation. 12/15/93.

105.0063 **Common Carrier.** An air carrier has a contract with the United States government for carrying persons and property. The contract is limited to a

maximum of one year with a right of further extension. The contract is also limited to specific days of the week. In addition, there is no indication that any particular aircraft was purchased by the air carrier for the government contract.

Under these circumstances, the use of the aircraft should be regarded as common carriage as long as the air carrier holds itself out to the public as a carrier of persons and/or property indiscriminately. This can be established by the air carrier's advertising in phone books, brochures, or other items. After this common carrier status is established, if it can be proven that the carrier has transported the public in several flights and has also had specific contracts with specific persons to haul them for a specific period of time, the carriage under specific contracts should also be treated as common carriage. 9/3/75.

105.0064 **Common Carrier.** A helicopter is leased to a person who holds an air taxi operating certificate from the Federal Aviation Administration. The helicopter is dedicated for use by a single client, under contract, who is also stated on the insurance policy covering its operation. In order for the helicopter to qualify for exemption under Regulation 1593(a)(1), the aircraft must be used as a common carrier of persons or property. As stated in Civil Code section 2118 " . . . every one who offers to the public to carry persons, property, or messages, excepting only telegraphic messages, is a common carrier of whatever he thus offers to carry." The above helicopter is dedicated exclusively for use by a single client. Therefore, it is not available "to the public" for carriage of person or property and it is not used as a common carrier of persons or property as required by Regulation 1593(a)(1). 1/13/81.

105.0065 **Common Carrier.** An aircraft owner leases his aircraft to a charter company operating under the authority of the Federal Aviation Administration. The charter company charters the aircraft to the aircraft owner's medical corporation and permits the aircraft owner to pilot the aircraft as the charter company's employee on these flights.

When the aircraft owner's medical corporation "charters" the aircraft for the purpose of having only the aircraft owner transported, this would not be recognized as a true charter if the aircraft owner is the pilot. Such use does not constitute use as a common carrier for purposes of calculating the principal use of the aircraft during the test period specified under Regulation 1593(b). When the aircraft owner's medical corporation charters the aircraft for the purpose of transporting several persons and the aircraft owner acts as the pilot, the charter will be recognized as common carrier use if the aircraft owner is a true employee of the lessee and if such use is common carrier use within the intent of Revenue and Taxation Code section 6366.1.

The intent of the Legislature in adopting section 6366.1, did not include extending an exemption to the use of an aircraft by the owner in a lease and sublease back arrangement. The Board will not regard the transaction as common carriage for the medical corporation for purposes of the exemption explained in Regulation 1593 if the sole purpose of the aircraft owner's employment with the lessee is to act as pilot of his aircraft when the aircraft owner's medical corporation charters the aircraft.

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Among the indications of a bona fide charter relationship are the following:

(1) If the aircraft owner is not available to act as a pilot on flights other than those chartered by the aircraft owner's medical corporation, the relationship with the lessee (charter company) will not be regarded as a true employment relationship.

(2) The aircraft owner must be treated as an employee of the lessee in the lessee's records as well as in his own records.

(3) The aircraft owner must be paid the same amount as any other pilot of equivalent experience.

(4) All applicable employment taxes and fees must be paid.

(5) The aircraft owner must satisfy all regulatory requirements of an air taxi or commercial operator carrier under applicable regulations.

(6) The rates to the medical corporation can be no lower than rates available to other charters. 11/2/89.

105.0065.500 **Cargo Containers, Pallets and Nets.** Section 6366 provides an exemption from tax for the sale of and the storage, use or other consumption of tangible personal property that is purchased on or after October 1, 1996 and becomes a component part of any aircraft as described by section 6366(a)(1) as a result of the maintenance, repair, overhaul, or improvement of that aircraft in compliance with FAA requirements.

Cargo containers designed to be secured and which are, in fact, secured to qualifying aircraft during flight qualify as component parts, sales of which are exempt. Cargo pallets and nets, if sold to contain the cargo during flight and which are, in fact, secured to qualifying aircraft during flight, will also qualify as component parts, sales of which are exempt. 12/2/97. (M99–1).

105.0066 **Common Carrier—Operational Use.** Where an aircraft is purchased for lease to a lessee who will use the aircraft as a common carrier in charter operations and will also use the aircraft for noncommon carrier flights, the lessee's ''operational use'' of the aircraft during the test period (Regulation 1593) determines whether the sale of the aircraft to the lessor is exempt from tax. If the lessee merely rents out the aircraft without a pilot or uses the aircraft for flight instruction, such use would be operational use that is not common carrier use. 3/27/84.

105.0066.500 **Common Carrier Presumption.** Subdivision (b) of section 6366 establishes a presumption that an aircraft was not purchased for use in common carriage if the aircraft owner does not receive in annual gross receipts from the lease of the aircraft at least twenty percent of the purchase cost of the aircraft to him or her, or $50,000, whichever is less. The period for determining the application of this presumption commences upon first operational use of the aircraft and ends after twelve months unless the aircraft is sold prior to that time, in which case the presumption test terminates on the date of the transfer. The $50,000 presumption is based on a one-year test period. If the test period is thus less than 12 months, the $50,000 presumption is adjusted on a prorated basis. For

example, if the purchaser sells the aircraft six months after the aircraft's first operational use by the purchaser, the presumption of section 6366(b) will arise if the purchaser has not received at least ten percent of the purchase price of the aircraft or $25,000 in gross receipts, whichever is less. 9/23/99. (2000–2).

105.0067 **Common Carrier Status—Sale to Related Corporation.** A corporation's use of two aircraft qualified for the common carrier exemption explained in Regulation 1593(a)(1). It then sold the two aircraft to a related corporation (100% of the stock of each corporation is owned by the same person). The sale was not a transfer of substantially all of the seller's assets. Thus, the sale does not qualify for the exemption provided by section 6281. Therefore, the transaction is a taxable sale unless the purchaser's use qualifies for the common carrier exemption.

Whether the seller's use of an aircraft had previously qualified for the common carrier exemption is not relevant to the determination of whether the purchaser's use qualifies for the exemption, regardless of the common ownership of the seller and the purchaser. Rather, upon the purchase of the aircraft, the purchaser of the aircraft owes use tax on its use unless that purchaser's use qualifies for the exemption. Accordingly, a new 12 consecutive months' test is required to determine if the purchasing corporation uses the aircraft in order to qualify its purchases for the common carrier exemption. 8/16/95.

105.0069 **Common Carrier Use.** A taxpayer purchased an aircraft for use in common carrier operations. The first operational use of the aircraft occurred on July 30, 1987. However, the FAA did not give the taxpayer authorization to use the aircraft as a common carrier until May 16, 1988. Therefore, any operational use prior to May 16, 1988, would not qualify as common carrier use.

Under regulations pertaining to common carrier operations, Part 135, subchapter (G) of Title 14 of the Code of Federal Regulations (CFR), each carrier can only operate a particular type of aircraft if it obtains authority for the specific category and class of aircraft. Accordingly, only the common carrier operations between May 16, 1988 to July 30, 1988, qualify in determining if more than one half of the 12 month test period was for use in common carrier operations. 1/7/94.

105.0070 **Common Carrier Use.** Taxpayer purchased a helicopter at a location outside California from a helicopter dealer. Taxpayer was a licensed pilot for fixed wing aircraft, and a student pilot for helicopters. Taxpayer and a flight instructor flew the aircraft to California. Taxpayer did not possess a commercial pilot license for helicopters at any time within the next twelve months (test period). The aircraft was leased to a firm, a licensed Part 135 carrier, which used the helicopter to take aerial surveying photos. The firm also subleased it to a television station involved in aerial camera filming of the Olympic Games. There were other uses of the helicopter that were not specifically identified.

Under common carrier provision, Part 135 of Title 14 of the Code of Federal Regulations, a Part 135 operator must comply with all rules of Part 135 (14 CFR 135.3(a)). Rules include that only authorized pilots are allowed to fly the aircraft and a log must be maintained of all use of the aircraft.

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Based on the information available, less than 50 percent of the helicopter's ''operational'' usage constitutes common carriage hours. The aerial surveying flights are specifically excluded from Part 135 operations (14 FAR Part 135.1(b)(4)(iii)). The use of the helicopter for television production, (broadcasting the Olympics) was a subrental since the ultimate control of the helicopter and pilot during flights was under the sublessee. Also, any use made of the helicopter while taxpayer was the pilot does not qualify since he did not have a commercial license to pilot the aircraft. Therefore, tax applies to the purchase price of the helicopter since it was not used more than 50 percent of the time in common carrier operation during the first 12 month test period. 1/13/94.

105.0076 **Corporate Aircraft Used in Interstate Operations.** An aircraft purchased out of state and brought into California within 90 days after purchase could qualify for the exemption provided in Regulation 1620(b)(2)(B) provided it is used continuously in the corporation's interstate operation (e.g., transportation of company's employees from one state to another). Intrastate flights in another state will not affect the exemption from the California tax. 9/15/83.

105.0080 **Corporations.** A corporation is a resident of the state in which it is organized. A California corporation remains a resident of this state even where it operates solely outside California. A corporation is not a resident of California within the meaning of that term as used in Section 6366 and 6366.1 if the corporation is not 'doing business' in California and was not incorporated under California law. Accordingly, a corporation must not be doing business in California or incorporated under California law if it is to qualify as a nonresident under such exemptions. 2/21/56; 4/12/84.

105.0085 **Crop-dusting.** Crop-dusting does not qualify as a common carrier flight. Although the aircraft carries the dusting material from the loading point to the location of the fields, such a flight is not regarded as a flight for the purpose of transporting property for compensation. Rather the flight is regarded as an agricultural service of crop-dusting. 5/14/91.

105.0087 **Delivery to Nonresident.** A California resident solicited donations from the public to pay for a helicopter which was to be used in a national park in Africa. The California resident agreed to purchase a helicopter from a California manufacturer F.O.B. Paloma, California. After delivery in California, the aircraft was shipped to Africa.

Section 6366 does not discuss whether the property is ''sold to'' the person receiving title from the seller or the person providing consideration for the contract. Consequently, the aircraft is ''sold to'' the person who will exercise a right or power over the aircraft.

If the obvious intention of the purchaser and seller was that the aircraft be delivered by a seller to a representative of the African country and if this intent was effectively carried out, title passed from the seller directly to the African

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country, notwithstanding that a California resident was required to pay seller for the aircraft. Under these circumstances, the sale would be exempt under section 6366.

On the other hand, if the California resident received the title or possession in lieu of title, the transaction would not be exempt under section 6366, notwithstanding the fact that the California resident subsequently gave the aircraft to the African country very shortly thereafter. 10/28/75.

105.0088 **Exclusive Use in Interstate Commerce.** A corporation purchases an aircraft that was first functionally used in interstate commerce outside California, entered California in the course of such use, and was then used continuously in interstate commerce while in California. However, several trips were made from San Jose to Long Beach Airport for purposes of service and maintenance. On these trips, only the crew members were on board.

If the sole purpose of the intrastate flights was to transport the aircraft to Long Beach for service and maintenance, the flights would not prevent the exemption from use tax based on exclusive use in interstate commerce. 3/17/92.

105.0089.500 **Fire Extinguisher, Loading and Unloading Equipment.** A fire extinguisher located on a ramp adjacent to an aircraft does not qualify for the exemption provided for in section 6366(a)(2) [now 6366(a)(3)]. Neither does equipment used to load and unload passengers and cargo. 4/7/97. (Am. 2000–1).

105.0090 **Firefighting Flights and External Load Operations.** Firefighting flights and external load operations will qualify as common carrier use provided: (1) The flight transports persons or property for compensation; (2) the flights are offered indiscriminately to the public or to some portion of the public; and (3) the flights are authorized by the person's FAA certificate.

When a person provides carriage for firefighters from Point A to Point B, that flight qualifies as a common carrier flight if it meets the above requirements.

Also, if a person provides carriage of firefighting supplies picked up at Point A and delivered to Point B, that flight qualifies as common carrier flight if it meets the above requirements.

If the same person carries water in its aircraft from Point A and drops the water on a fire at Point B, this flight would not qualify as a common carrier flight. Such a flight would not be regarded as a flight for the purpose of transporting persons or property for compensation but rather as a flight to provide the service of firefighting. 4/26/91; 5/14/91.

105.0100 **Gliders.** Although gliders are designed for navigation in the air, they are not aircraft within the meaning of Section 6274 because they are not powered contrivances. 4/16/68.

105.0120 **Helicopter.** A complete helicopter is an aircraft within Section 6366 exemption, but parts thereof are not within the exemption. 10/24/52.

105.0122 **Helicopters Used in Fire Fighting.** Rotocraft or helicopters used in fire fighting and external-load operations may qualify for the common carrier

exemptions provided in Sections 6366 and 6366.1. This is true regardless of whether that use is authorized under Part 133, Part 135 or any other part of the Federal Aviation Regulations. However, any operation as a common carrier which is not within the use for which certification is obtained does not qualify for the exemption, e.g. a use which is in violation of the certificate.

To qualify, the aircraft must be used in common carrier operations and those operations must be consistent with its licensing authority. For example, a helicopter transporting persons or property for compensation on flights authorized by Part 133 of the Federal Aviation Regulations would qualify, assuming the services are offered indiscriminately to the public or some portion of the public for compensation. 4/26/91.

105.0125 **Helicopter Used for Medical Transportation.** A taxpayer's contract with a hospital requires that the taxpayer provide air transportation services to patients of that hospital only and the hospital pays the taxpayer for those services. The hospital also has and exercises control over when and where the taxpayer will transport their patients.

When an aircraft is dedicated exclusively for use for a single client, it is not available ''to the public'' for carriage of persons or property and is not used as a common carrier of persons or property for purposes of Regulation 1593(a)(1). The fact that the taxpayer is authorized to operate as a common carrier under Federal Aviation Administration regulations does not mean the taxpayer's operations, in this case, are that of a common carrier. Thus, the taxpayer is not offering its services to the public or a portion of the public as required for the exemption from tax provided for aircraft leased and used in common carriage. 11/22/96.

105.0130 **Hot Air Balloons.** Hot air balloons are not an ''aircraft'' within the meaning of Section 6274. The powered heating unit installed on the hot air balloon allows the operator to control the altitude of the balloon. Horizontal movement, however, is subject to the movement of the wind or air flow. While the operator may select a course of direction by raising or lowering the balloon into the desired air flow, the actual movement and control is caused by the air flow and not a powered navigational unit. This is typified by the fact that under certain weather conditions the operator may not be able to dictate the direction of travel. 1/27/86.

105.0131 **Hot Air Balloons.** The Board has ruled that a hot air balloon is not an aircraft for purposes of Regulation 1610. The application of tax to the transfer of a balloon is the same as it is to tangible personal property in general. 3/28/91.

105.0140 **Hovercraft.** A hovercraft, a craft which is propelled three to four feet above the surface of land or water on a cushion of air created by a turbine powered fan, is not designed for transportation of persons or property in ''navigable airspace'' and, therefore, does not qualify as an aircraft. 2/7/68.

105.0155 **Lease to Common Carrier After Private Lease.** As set forth in Regulation 1593(b)(1), whether a purchaser or lessee of an aircraft is using that aircraft as a common carrier of person or property, only the use of the aircraft

AIRCRAFT (Contd.)

during the first 12 consecutive months commencing with the first operational use of the aircraft will be considered. Thus, a lessor of an aircraft leasing the aircraft to private individuals and reporting tax based upon fair rental value for the first two years from the date of purchase must continue to report tax based upon fair rental value on a subsequent lease to a common carrier. In order for the common carrier exemption to apply, the aircraft must be used in common carriage for more than half of the twelve month test period. The test period commences with the first ''operational use'' of the aircraft. 11/21/89.

105.0160 **Lease of Part of Aircraft.** To facilitate the financing of a purchase of an aircraft by an airline, the engine and propeller equipment of the aircraft are titled in a third party who will concurrently lease the engine and propeller equipment to the airline. The airline takes title to the balance of the aircraft and takes delivery of the complete aircraft. The lease contains an option permitting the airline to acquire title to the equipment from the lessor in due course. The exemption in Section 6366 is unaffected by this arrangement. The airline has the beneficial ownership of the entire aircraft as well as actual title to all but the engine and propeller equipment, and will ultimately secure title to this property. 5/14/58.

105.0170 **Leased Aircraft—Repair Parts.** The lessee of an aircraft has the statutory obligation to make the necessary repairs to the aircraft in its possession, and to maintain them in operable condition. Therefore, parts installed by the lessee to repair or maintain the aircraft are not sales to the lessor of the aircraft, notwithstanding the lease provision passing title to such parts to the lessor. The purchase of such parts by the lessee are not exempt as sales for resale to the lessor, nor sold back to the lessee by the lessor in the form of a lease exempt under section 6366.1. The lessee is the consumer of the parts. 9/28/72; 5/29/96.

105.0180 **Leasing.** The assignment of an aircraft to a holding company and the leasing of it back to customers while the aircraft is in California, is a use ''otherwise than in removal'' and hence would exclude the transaction from the exemption afforded in Section 6366. 8/3/54.

105.0185 **Loan of Engines.** Due to a delay in delivery of engines ordered with an airplane, the airplane manufacturer loaned other engines to the airplane purchaser. The loan constituted a use by the manufacturer, taxable at fair rental value. There is no lease because there is no consideration. The exemptions of sections 6366 and 6366.1 apply only to aircraft and not to engines and thus, the loan of the engines is not exempt under these statutes. 12/20/85.

105.0190 **Modifications to Aircraft.** A company which sold modular kitchens for installation on aircraft may not claim the exemption if it is unable to demonstrate that the kitchens were installed as part of or a step in the manufacture or completion of a new aircraft. The sale of a modular kitchen as part of a repair or replacement in an aircraft which had previously been sold and placed in common carrier service does not qualify for the exemption described in Regulation 1593(d). 1/17/95.

AIRCRAFT (Contd.)

105.0192 **Noncommon Carriage Operation.** Air taxi operators are authorized to operate by the Federal Aviation Administration under Part 135 of Title 14 of the Code of Federal Regulations. Under ''Part 135'' the carrier must have the sole possession, control and use of the licensed aircraft during flight. Other uses of aircraft, such as rentals, flight instruction, and the providing of a pilot for a fee are regulated by Part 91.

Many aircraft owners make uses of the aircraft under both Part 135 and Part 91. The fact that the operator has been licensed under Part 135 does not cause Part 91 flights to be treated as exempt. For example, when an aircraft is rented to a customer with a pilot but for a separate fee, and the customer has ultimate control over the aircraft and pilot for passenger and/or cargo flights which are flown only pursuant to Part 91 rules, the flights are not for common carriage purposes. 11/3/93.

105.0195 **Powerline and Pipeline Patrol.** The key issue in determining whether the usage of an aircraft qualifies for the common carrier exemption is whether the aircraft was used for transporting persons or property. An aircraft used only for power line and pipeline patrol would not qualify for the exemption. However, the use would not be disqualified just because the transport of persons or property happens to be while also patrolling a pipeline or powerline. Thus, if the aircraft was hired to fly an employee of the owner of the pipeline or powerline along a powerline the use of the aircraft would qualify for the exemption so long as all other criteria were met. If the aircraft merely flew the line without transporting either persons of property, the aircraft would not qualify for the exemption. 1/28/93.

105.0197 **Principal Use Test.** Flights from an out-of-state purchase point to points in California are regarded as being included in total flight hours in determining whether the principal use of an aircraft is exempt. Flights from a base to a repair location are also included. Neither type of flight is regarded as exempt. The principal use test begins with the first operational use of aircraft after purchase. The time at which charter flight approval is issued by the Federal Aviation Authority has no bearing on the principal use test other than flights prior to the issuing of approval cannot be regarded as exempt. 3/15/94.

105.0200 **Purchase of Aircraft.** A taxpayer purchases an aircraft from an unrelated party with the intent to utilize the aircraft in the chartering business. After inspection and refurbishing of the aircraft the taxpayer intends to transfer the aircraft to a newly formed corporation in exchange for all of that corporation's shares. The taxpayer holds a valid seller's permit and purchases the aircraft from a person who was not required to hold a seller's permit by virtue of its sales of aircraft.

The taxpayer did not purchase the aircraft for resale but rather for the purpose of transferring it to a commencing corporation in exchange for stock. This is a use subject to tax. The subsequent transfer of the aircraft to the new corporation solely in exchange for first issue stock of that commencing corporation, with no other consideration, is not a sale subject to sales or use tax. 7/27/92.

AIRCRAFT (Contd.)

105.0204 **Refrigerators Installed in New Aircraft.** The following three scenarios describe transactions under which refrigerators are incorporated into new aircraft:

(1) The refrigerator is sold and delivered to an aircraft manufacturer. The manufacturer incorporates the refrigerator into a galley. The galley is checked to determine that all specifications of the design have been met. After the check, the galley is installed into the aircraft and after the aircraft is completed, it is delivered to a common carrier.

(2) The refrigerator is sold to a common carrier who instructs the seller to deliver the refrigerator to a third party galley manufacturer instead of delivering the refrigerator to the common carrier or an aircraft manufacturer. The galley manufacturer designs the galley and installs the refrigerator into the galley, and determines that all the specifications of the design have been met. Upon completion, the galley is shipped to the aircraft manufacturer. The aircraft manufacturer installs the galley into the airframe and the finished aircraft is delivered to the common carrier.

(3) The refrigerator is sold and shipped directly to a common carrier who instructs a third party to install the refrigerator into a galley that will be incorporated into the finished aircraft.

Under section 6366, as long as the installation of the refrigerators is a step in the manufacture or completion of a new aircraft, the sales of the refrigerators are exempt from tax. Thus, under all three scenarios, the sale of the refrigerators is eligible for the exemption as long as the purchase of the aircraft otherwise qualifies as a common carrier under section 6366, as explained by Regulation 1593. 2/10/97.

105.0205 **Replacement Parts for Aircraft.** Periodic maintenance on aircraft leased to a common carrier is performed out of state. The aircraft returns to California in the course of resuming its role as a common carrier.

Use tax does not apply to the purchase of any parts installed as part of the periodic maintenance out of state. If the replacement parts are installed as a result of periodic maintenance performed in California, sales tax would apply to the sale of the replacement parts. 3/9/88.

(Note: Amendments to section 6366, effective October 1, 1996, re aircraft parts.)

105.0220 **Sale and Installation of a Wiring System to a Foreign Carrier.** An equipment manufacturer sells and installs a wiring system in a new aircraft purchased by a foreign carrier. This sale and installation is exempt from sale or use tax under Section 6366. This is based on the theory that sale and installation of the wiring system constitutes a step in the manufacture of a completed aircraft. 12/27/68.

105.0230 **Sale of Part of an Aircraft.** A manufacturer of aircraft parts is contracting with a common carrier for the sales of an ‘‘aircraft.’’ The common carrier will purchase the ‘‘aircraft’’ without any engines being furnished by the manufacturer and, instead, will furnish its own engines.

AIRCRAFT (Contd.)

The delivery of the aircraft in California will occur under one of the following three fact patterns:

(1) The purchaser will take delivery after manufacturer installs the purchaser's engines onto the aircraft.

(2) The purchaser will take delivery after a contractor other than manufacturer installs the purchaser's engine onto the aircraft.

(3) The purchaser will take delivery of the aircraft with engines being loaned by the manufacturer. The purchaser will then have its own engines installed elsewhere and return the loaned engines to the manufacturer.

In each of these cases, the proposed sale of the airframe with installed engines to a common carrier, as described above, would qualify as an exempt sale of an aircraft pursuant to section 6366. 4/28/86.

105.0260 **Simultaneous Transactions.** An aircraft manufacturer sells a plane to Company A, with delivery in California. Company A simultaneously leases the aircraft to Company B, a Nevada Corporation. Company B simultaneously leases it to C, who is a common carrier. Since there is no intervening use of the aircraft, the transactions would come within the exemption provided by Section 6366.1. The parties should obtain and retain for their records exemption certificates, from the other parties involved, to support that the sale and lease of the aircraft is not subject to tax. 4/5/88.

105.0290 **Sublease to Common Carrier.** An aircraft manufacturer has entered into a sales agreement for an aircraft with the stock holding company of common carriers X and Y. The stock holding company has assigned its rights under the agreement to a leasing company, a subsidiary of the aircraft manufacturer, which will purchase the aircraft from the manufacturer and lease it to the stock holding company. The stock holding company will sublease the aircraft to common carrier X which will in turn sublease the aircraft to common carrier Y. Common carrier Y will place the aircraft in commercial operation both within and without California.

This transaction qualifies for the aircraft exemption provided in section 6366.1. 6/28/85.

105.0293 **Sublease in Common Carrier Service.** Nothing in the language of section 6366.1 prevents the exemption from applying in a situation where an aircraft is purchased by a leasing company who leases it to another entity who in turn leases it to a carrier. The section exempts the sale of aircraft "which are leased, or are sold to persons for the purpose of leasing, to lessees using such aircraft as common carriers." A sublessee may operate as the carrier. 4/21/80.

105.0296 **Telephones Installed on Aircraft.** Telephones permanently installed in the passenger seat backs or consoles for use by passengers to make calls are not parts associated with the functional aspects of the aircraft nor are they parts of a safety feature of the aircraft. Rather, they fall into the category of non-essential or comfort-related item under Regulation 1593 and tax applies to the charges made for these items. 9/10/99. (2000–2).

AIRCRAFT (Contd.)

105.0550 **Use of Aircraft.** An aircraft is withdrawn from resale inventory nine times for use prior to its sale. Three times it is leased, three times it is used for personal purposes, and three times it is used for air taxi operations involving common carriage of persons or property. Tax is due on the fair rental value for the personal purposes and the leasing but is not due on the fair rental value for the use of the aircraft in common carrier operations since such use is exempt under section 6366. Also, tax applies to the fair rental value of the other uses only during the time the aircraft is within California. 11/4/80.

ALTERATIONS

See Producing, Fabricating and Processing Property Furnished by Consumers—General Rules. New clothing, alterations to, see Manufacturers of Personal Property.

110.0000 ANIMAL LIFE AND FEED—Regulation 1587

Impounded animals, sale of, see also State and Political Subdivisions.

(a) ANIMAL LIFE

110.0003 **Allocation of Purchase Price to Unborn Foals.** A company who is in the business of breeding, racing and selling horses, purchased two mares with unborn foals from an out-of-state retailer for a lump sum of $225,000. The mares were purchased for breeding purposes in California. The company contends that the foals were purchased for resale so that only $125,000 was actually paid for the mares.

A portion of the purchase price of the mares cannot be allocated to the unborn foals on the basis that the foals are to be resold. The contract of the sale did not separately state a value for the foals, nor provides for a refund of any portion of the purchase price if the foals were born dead. The mares were valuable in the condition of being with foal. Accordingly, the full purchase price paid for the mares is subject to use tax with no allocation for the unborn foals. 8/20/92.

110.0005 **Animal Life—Food Products.** In determining whether animal life is ''of a kind the products of which ordinarily constitute food for human consumption'' the proper test is whether the animals or birds in question, are in fact generally used as food for human consumption in the area where they happen to be located. This applies even though they might actually be used there for exhibition purposes.

The fact that people in Asia or Africa have eaten a particular type of deer does not dictate the conclusion that these animals ordinarily constitute food for human consumption, within the meaning of what the Legislature intended. It is more appropriate to consider whether a particular animal is ordinarily used for food for human consumption in California, as distinguished from some foreign country. Thus, the test to be followed is whether the particular specie of animal life or its products, constitutes food for human consumption in California. 4/18/73.

110.0020 **Breeding Shares.** The sale of the right to have a thoroughbred mare bred to a particular stallion once each year during the breeding season without charge is not the sale of tangible personal property and is thus not subject to tax. 11/2/62.

ANIMAL LIFE AND FEED (Contd.)

110.0025 **Breeding Stock.** Use tax presumptively applies to the purchase of breeding horses for the period in which the horses are entered on the books of the purchaser as capital assets and are physically used in California. The statute of limitations begins to run as of that period. The breeding of the horses will not ordinarily be seen as exempt demonstration and display after the horses are capitalized on the purchaser's records. If a horse purchased ex-tax has been capitalized and bred but is resold prior to the purchaser's obtaining any depreciation or capital gains benefits, consideration shall be given to any evidence submitted by the purchaser that the breeding of the horse was only for purposes of demonstration and display. 7/10/74.

110.0030 **Bullfrogs.** The tax applies to the sale of experimental bullfrogs which are not of a type ordinarily used for human consumption, but does not apply to those which are of such a type. 1/25/63.

110.0035 **Cattle Teat Dips and Udder Washes.** Teat dips and udder washes that are applied to cows for the prevention and control of mastitis are considered "drugs or medicines" the sales of which are exempt from tax under section 6358(e). 11/19/97. (M99–1).

110.0040 **Chinchillas.** Where a purchaser of a number of pairs of chinchillas for resale purposes, still intends to sell them upon obtaining a seller's permit, he will not be deemed to have made a taxable use of them until such time as he no longer holds them for sale or until such time as he uses them for any other purpose. The fact that in the interim a number of the pairs have had litters does not constitute a use of such animals. 11/6/53.

110.0050 **Dwarf Rabbits.** Rabbits are considered to be animal life of a kind the products of which ordinarily constitute food for human consumption, and sales of rabbits, including dwarf rabbits, will not be subject to sales or use tax regardless of whether or not the rabbits or its products are actually used as food for human consumption. 1/23/96.

110.0060 **Sale to Educational Institutions for Research.** The sale of animals of a kind ordinarily used for human consumption is exempt from sales tax even though the sale is made to an educational institution for research purposes. The exemption would not apply to retail sales of animal life, such as cats, dogs or horses, since these are not food animals. Sales tax is applicable on the sale of animal serum and red cells because the serum and cells are not considered as a form of animal life used for human consumption. 3/5/70.

110.0070 **Fastrack.** Fastrack is a product which increases the growth of lactic-acid producing bacilli in the animal's digestive tract. Fastrack is exempt from tax when sold to be used as an ingredient for feed which is fed to food animals or to any non-food animals which are to be sold in the regular course of business. 10/18/90. (Am. 2003–1).

110.0072 **Feedstore.** Feedstore is a concentrated source of live lactic acid producing bacteria for inoculation of silage, haylage and high moisture corn.

ANIMAL LIFE AND FEED (Contd.)

Although the bacilli themselves are not nutrients, the lactic acid they produce improves the ensilage by inhibiting the growth of harmful bacteria, reducing spoilage, and making the ensilage more easily digested. Accordingly, Feedstore qualifies as an animal feed exempt from tax if sold as feed for food animals or for any non-food animals which are to be sold in the regular course of business. 10/18/90. (Am. 2003–1).

110.0075 **Food for Human Consumption.** The following listed animals do not qualify as a form of animal life of a kind the products of which ordinarily constitute food for human consumption. Accordingly, tax applies to the retail sale of these animals:

Spiny anteaters

Marsupials (Kangaroos, opossums, etc.)

Primates (Monkeys, etc.)

Armadillos, sloths and anteaters

Rodents (squirrels, etc.)

Carnivores (bears, dogs, cats, seals, etc.)

Elephants

Hyrax (rodent like mammal native to Africa and Southeast Asia)

Horses, tapirs, rhinos

Hippos, camels, giraffes

All reptiles (sea turtles, tortoises, crocodiles, alligators, lizards, and snakes). 12/21/59.

110.0085 **Game Farm.** An individual operates a game farm where the prime function is the breeding and sale of offspring from zebras, camels, llamas, miniature horses, miniature donkeys, scotch cattle, Texas longhorn cattle, and buffalo. Following is the application of tax in connection with a ‘‘game’’ farm:

The test is whether the animals qualify as animals the products of which ordinarily constitute food for human consumption. Zebras, camels, llamas, miniature horses, and donkeys would not qualify. Scotch cattle, Texas longhorn cattle, and buffalo qualify since cattle and buffalo are species the products of which ordinarily constitute food for human consumption. (Also see Annotations 110.0155 and 110.0560.) The sales of the animals (or the offspring) which do not qualify under the above test are subject to tax. The use tax on the importation of the animals which are not exempt under section 6358 would apply in the same manner as in the case of the sale of any other tangible personal property not exempted from such tax. 6/8/71.

110.0100 **Hamsters,** tax applies to retail sales of. 1/12/50.

110.0120 **Insects.** Sales of insects, which destroy other insects harmful to growing crops, to farmers for their own use and to firms for use in agricultural pest control services are taxable retail sales. A firm which raises and collects

insects and uses them in its own pest-control service, is the consumer thereof, provided it does not make a separate charge to farmers for the insects used. 11/24/64.

110.0140 **Karakul Sheep,** sales of, are exempt, as this breed is definitely used for food purposes although used in wool production to a greater extent than the ordinary breed of sheep. 5/29/51.

110.0150 **Fish Bait—Live.** Sales tax does not apply to the sale of the following fish, mollusk, and crustaceans, when sold alive. These animals are animals of a kind the products of which ordinarily constitute food for human consumption. These sales are exempt under Section 6358(a) even though the animals may be used for bait by deep-sea fishermen. Sales of living animals for bait purposes may qualify as sales of living animals ''the products of which ordinarily constitute food for human consumption'' under Section 6358, even though the sales do not qualify as sales of food products for human consumption under section 6359. Section 6358 is an exemption for certain living animals. Section 6359 is an exemption for food to be consumed by humans.

1. Anchovies
2. Squid
3. Spanish Mackerel
4. Tom Cod (Kingfish)
5. Herring
6. Queenfish
7. Smelt
8. Grunion
9. Pompano
10. Various Perch
11. Sardines
12. Shrimp (Bay)

4/16/75; 2/6/92.

110.0155 **Llamas.** Sales of llama as a source of food for human consumption are subject to sales tax. Llama are not a form of animal life the products of which ordinarily constitute food for human consumption. 10/7/88.

110.0160 **Nutria.** Sales of animals known as Nutria are not exempt as sales of animals of a kind the products of which ordinarily constitute food for human consumption. Sales of Nutria meat for food for human consumption is, however, exempt from tax. 10/24/57.

110.0180 **Rabbits.** Sales of rabbits are tax exempt even though used for laboratory purposes. Rabbits are animals ''of a kind the products of which ordinarily constitute food for human consumption,'' but mice and guinea pig sales are taxable. 10/11/50.

110.0200 **Race Horses—General Rules of Application of Tax.**

1. The sales or use tax, as the case may be, applies with respect to sales of, and the storage, use, or other consumption of race horses in this state to the same

ANIMAL LIFE AND FEED (Contd.)

extent as to other tangible personal property the sale, storage, use, or other consumption of which is not specifically exempted from the tax.

2. Entering a horse in a race for which a purse is offered is a ''use'' other than retention, demonstration, or display for the purpose of sale and is subject to the use tax in a proper case, regardless of the subsequent sale of the horse.

3. Section 6015 of the Sales and Use Tax Law provides that a person conducting a claiming race is the retailer of horses claimed. 9/15/50. 10/08/02. (Am. 2003–2).

(Note: Revenue and Taxation Code section 6358.5, operative September 1, 2001, provides a partial exemption from the state portion of the sales and use tax for sale or use of racehorse breeding stock under specified circumstances.)

110.0220 **Race Horses.** Race horse purchased out of state was injured en route to California and it was impossible to race him in the state as originally planned. Owner removed the horse to his ranch out of state. Eleven months after purchase the horse was raced once in California, and was then returned out of state for stud service where it was eventually sold.

The length of time between the horse's purchase and its first use in California, the brief use in the state (one race) and its subsequent use and sale out of state justify the conclusion that it was not purchased for use in California. 9/1/53.

110.0280 **Race Horses—Presumption.** Since racing of a horse constitutes use, a horse which is purchased from an out-of-state retailer and is first raced in the state is presumed to be purchased for use in this state and is subject to tax under Section 6201 of the Sales and Use Tax Law. The same presumption of use applies to horses purchased out-of-state but foaled first in this state; however, this presumption can be overcome by showing substantial outside use before being brought into California. 10/27/64. (Am. 2003–2).

(Note: Regulation 1535, operative September 1, 2001, provides a partial exemption from the state portion of the sales and use tax for sale or use of racehorse breeding stock under specified circumstances.)

110.0310 **Sales of Mosquito Fish.** A mosquito abatement district raises mosquito fish and releases them into district waters as the fish eat mosquito larvae. They sometimes raise more fish than they can use. In such cases, they enter into agreements with other mosquito abatement districts pursuant to section 6500 et seq. of the Government Code to distribute the excess in return for reimbursement of costs in the form of cash, materials or services. If the district makes more than two sales of fish in any 12 month period, the sales are taxable as all the elements of a taxable sale are present. There is a transfer of title or possession, by a seller, for consideration, for a purpose other than resale, and there is no specific exemption for sales by or between governmental units. The fact that the sale is made under the authority of the Government Code does not alter the tax consequences. 5/10/91.

110.0315 **Semen.** Sales of bull semen for artificial insemination of cows are exempt from sales tax. The sperm constitutes a life form of an animal. Also the product, i.e., the young after fertilization, ordinarily constitutes food for human consumption. 11/1/73.

ANIMAL LIFE AND FEED (Contd.)

110.0340 **Tropical Breeding Fish.** Purchases of breeding fish by breeder are taxable since they are not of a kind the products of which constitute food and are obviously not bought for resale. 12/22/52.

110.0350 **Zoos.** Sales of fish to zoos or aquariums to feed animal life of a kind which do not ordinarily constitute food for human consumption are subject to sales tax, unless the fish sold to the zoos for this purpose is live and of a kind the products of which do ordinarily constitute food for human consumption, e.g., live halibut. 2/6/80.

(b) FEED

110.0360 **Actual Character of Product,** rather than statements on label or tag, determines whether product is an exempt feed or taxable medicine. 5/4/51.

(Note: Changes to drugs and medicines in section 6358.4, operative April 1, 1996, and subdivision (e) of section 6358, operative January 1, 1997.) (Am. 2000–2).

110.0363 **Actual Use as Food.** Animal feed sold for ''any form of animal life of a *kind* the products of which ordinarily constitute food for human consumption'' is not subject to sales or use tax regardless of whether or not the animal life or its products are actually used as food for human consumption. For example, sales of rabbit food for a pet rabbit are not subject to tax. 11/13/95.

110.0370 **Animals and Feed.** Regulation 1587 provides that in the absence of evidence to the contrary, it is presumed that sellers of feed which is of a kind ordinarily used only in the production of meat, dairy, or poultry products for human consumption are making exempt sales of such feed for use in the production of meat, dairy or poultry products for human consumption. Such sellers therefore generally need not secure feed exemption certificates. The presumption of exemption also applies with respect to sales in small units (two standard sacks of grain or less and/or four bales of hay or less) of feed of a kind customarily used either for food production or other purposes (feeding work stock), or with respect to sales of feed that is specifically labeled by the manufacturer for food animals. This presumption of exemption does not extend to sales of other feeds even though the particular type of feed may be used 80% of the time to feed animal life of a kind used for human consumption. 7/14/81. (Am. 2000–2).

110.0374 **Anti Scours Action Program (ASAP).** ASAP is a nonmedicated oral dehydration therapy for young milk-fed calves suffering from scouring and diarrhea. It contains primarily roughage, sweeteners, fat, whey, vitamins, and minerals. The product is mixed with water and fed to young calves in place of milk. It can be used in conjunction with antibiotics and provides ''a rapidly available energy source for the weak calf.'' It replaces milk feeding in the calf's diet and contains nutrients. ASAP has significant nutritional value and, therefore, qualifies as a tax-exempt feed under Regulation 1587. 7/19/90.

ANIMAL LIFE AND FEED (Contd.)

110.0380 **APS #5, APF-1G.** Fortafoods, Choline Chloride, Niacin, Calcium Pantothenate and Parvo are exempt foods while Megasal and Enheptin are taxable drugs. 12/7/51.

(Note: Changes to drugs and medicines in section 6358.4, operative April 1, 1996, and subdivision (e) of section 6358, operative January 1, 1997.) (Am. 2000–2).

110.0400 **Aureomycin.** Aureomycin purchased for incorporation into animal feed to be sold is exempt from tax. 12/20/56.

110.0440 **B-Y-21,** described as ''dried fermentation solubles from grain'' for use in mixing with feeds as a source of riboflavin, is added to provide nutrients and is therefor an exempt feed. 9/24/51.

110.0480 **"Bio-Fac" and "Feed-Ani."** These are identical products and neither qualify as exempt feeds. 8/18/55.

(Note: Changes to drugs and medicines in section 6358.4, operative April 1, 1996, and subdivision (e) of section 6358, operative January 1, 1997.) (Am. 2000–2).

110.0500 **Birds.** Sales of food and seeds for ornamental and pet types birds are taxable when sold to persons who will feed it to birds which they have as pets. Tax does not apply to sales of feed to breeders of birds nor to retailers of birds for feeding purposes while such birds are being held for sale in the regular course of business. 5/10/54.

110.0560 **Buffalo Feed.** Sale of lima bean straw as feed for buffalo is exempt as a sale of feed for animal life the products of which ordinarily constitute food for human consumption. 5/4/55.

110.0600 **Cal-Min.** Laboratory analysis indicates that Cal-Min, containing Montmorillonite clay, has significant nutritional value when fed to animals, promoting growth and preventing osteoporosis. The Department ofAgriculture has therefore accepted the manufacturer's claim that Cal-Min should be classed as a nutritive product and not as an inert material. Accordingly, Cal-Min is regraded as a feed under Section 6358 and Regulation 1587. 6/22/65.

110.0602 **Calf First Aid.** Calf First Aid appears to be similar to Calf Probiotic-Plus and also appears to provide the normal nutritional requirements for a newborn calf. If so, this item would also be a ''feed'' and its sales would be exempt from sales tax. 7/27/93; 10/21/93.

110.0604 **Calf Probiotic-Plus.** Calf Probiotic-Plus is mixed with water or milk and given to calves for a period of 30 days and has concentrated amounts of vitamins. The long feeding period, along with the fact that it is fed to new born calves, indicates that it provides the normal nutritional requirements to promote growth in young calves. If so, this item is a ''feed'' and its sales would be exempt from sales tax. 7/27/93; 10/21/93.

ANIMAL LIFE AND FEED (Contd.)

110.0606 **Cattle Probiotic-Plus.** The label for Cattle Probiotic Plus does not indicate that this item is for treatment of any specific deficiency nor does it indicate that it is fed for a limited time period. While the label is not conclusive of whether or not this item is a ''feed'', it is assumed from the lack of labeling regarding the treatment of disease that this item provides the normal nutritional requirements for cattle. If so, this item qualifies for exemption as ''feed''. 7/27/93; 10/21/93.

110.0610 **Cattle Stress Bolus.** The label for Cattle Stress Bolus indicates it is for aiding in the recovery from stress associated with a variety of events, i.e., new arrivals, scours, etc. The pill is given to beef and dairy cattle for a limited period of time (three days). Given the concentrated amounts of vitamins and the limited time this pill can be given to cattle, the purpose of this item appears to be for ''overcoming of a specific deficiency'' and is thus regarded as a ''drug''. Sales of this item are subject to the sales tax. 7/27/93; 10/21/93.

(Note: Changes to drugs and medicines in section 6358.4, operative April 1, 1996, and subdivision (e) of section 6358, operative January 1, 1997.) (Am. 2000–2).

110.0620 **Chinchilla Feed.** Feed purchased for chinchillas which are subsequently killed for their furs, said furs being sold, constitutes a tax exempt feed. 5/18/56.

110.0640 **Crop Preserver Added to Hay.** A crop preserver added to hay at the time of baling for the purpose of retarding bacterial action is not within the feed exemption and in reality is a manufacturing aid used to expedite the baling of hay. As such, it is subject to sales tax. 6/4/53.

110.0645 **Custom Bagging Service.** A business activity provides custom bagging service of agricultural products for unrelated third parties. A truck hauls the products to the bagging machine where a conveyor takes the products to a rotor shaft that presses the feed into a bag. It takes two or three hours to fill a 250 ft. long bag. Once the material is put into the bag, the contents ferment (i.e., ensilage takes place) for a period of three weeks. The bagging process keeps the feed from spoiling. The fermenting process inside the bag makes the feed more edible by the cattle it is later fed to. Failure to bag alfalfa may result in either putrefying acids creating an inedible and wasted crop or a poor pack, incomplete fermentation and excess spoilage.

The business is ''processing'' the agricultural products prior to bagging them. The process preserves and enhances their food quality for the livestock that will ultimately consume it. The bags are ''sold with their contents.'' Since the contents are feed for animal life of a kind the product of which ordinarily constitutes food for human consumption, (i.e., cattle) the business' sales of its products are exempt from sales and use tax. The business may also purchase the material used in this process free of tax by giving its suppliers a resale certificate for each transaction. 9/14/90; 2/15/91.

ANIMAL LIFE AND FEED (Contd.)

110.0647 **Dog Food as Bait for Crayfish.** Sale of dog food to be used as bait for crayfish by commercial sellers of crayfish are subject to tax. 7/20/90.

110.0650 **Drugs Used in Feed Manufacturing.** The following list of substances are nontaxable when incorporated into feed used or sold as feed for animal life of a kind the products of which ordinarily constitute food for human consumption. Tax does not apply regardless of whether the substance is used to promote growth or to prevent disease in animals which consume the feed.

A D & E Prmx
ADRK Prmx 83
Amprol
Amprol Plus
Bacitracin MD 50
Bio Cox
BV Supp. E. Prmx
Coban
Corbosep
CTC 50
Flavomycin
Furox 100 & 180
Gallimycin
Ipropran
Lincomix 8/30/85.
Manganese Sulfate
Nopstress
Olson Layer Prmx
Pen Strep
Piperazine
Rofenaid
Stepcillin F-25
Stutts Starter Prmx
TM 50 & 100
Trace #10
T-Vit G 83
T-Vit SB 83
Tylan 10
Vitamin D & E

(Note: Changes to drugs and medicines in section 6358.4, operative April 1, 1996, and subdivision (e) of section 6358, operative January 1, 1997.) (Am. 2000–2).

110.0660 **Earthworms.** A sale of feed to a person in the business of raising and selling earthworms is exempt from tax. 11/4/53.

110.0670 **Ensilo-Mix, Silo-Guard, and Silage Mate.** Sales of Silo-Guard, Ensilo-Mix, and Silage Mate are exempt from sales tax when sold to be used as an ingredient of products, such as silage, which are feed for any form of animal life the products of which ordinarily constitute food for human consumption or are to be sold in the regular course of business.

Portions of these products remain on the silage when consumed by the livestock which is sufficient for the products to be considered as an ingredient of the silage for purposes of Regulation 1587. 4/1/86.

110.0680 **Food Additives.** Cattle Lure, Molasses Intensifier, Standard Flavors, Stock Charm, Kem-wet, End-ox, Mold Curb, and Fat Mask are added to animal feed to enhance or cover flavors, increase solubility or stop the formation of oxygen, bacteria, fungi, or odors. They may be purchased ex tax when they are to become part of an exempt feed. 5/31/66.

ANIMAL LIFE AND FEED (Contd.)

110.0700 **Fish Food, Medicine.** Purchases of medicine by breeder of tropical fish are taxable; purchases of feed are exempt since fish are sold in the regular course of business. 12/22/52.

(Note: Changes to drugs and medicines in section 6358.4, operative April 1, 1996, and subdivision (e) of section 6358, operative January 1, 1997.) (Am. 2000–2).

110.0710 **Liquid Oxygen to Aerate Water.** A company raises fish which it sells to the food service industry. Since the density of fish in its ponds is too great for them to get enough oxygen from the water naturally, the company adds liquid oxygen to the water. Sales of liquid oxygen to the company are subject to tax. Liquid oxygen is not used for the prevention or control of disease and, therefore, does not qualify as ''drug'' or ''medicine'' under section 6358.4. 11/19/97. (M99–1).

(This opinion was superseded by amendment to subdivision (e) of section 6358, operative January 1, 2000, to include oxygen within the exemption for sales and purchases of drugs and medicines administered to food animals.) (M99–1; Am. 2000–2).

110.0720 **"Fluke" Liver.** ''Fluke'' liver when processed as a suitable feed for trout, is exempt from sales tax when sold for use as such feed. 8/13/53.

110.0755 **Horse Feed.** Sales tax applies to the sale of hay to a person to feed a pet horse or a work horse. On the other hand, tax would not apply to the sale of hay to a person to feed a horse the person was holding solely for sale in the regular course of business. In that event, the seller of the hay should timely take an exemption certificate from the purchaser. If the seller does not take a timely certificate, the seller has the burden of showing that the sale qualifies for the exemption. 2/6/97.

110.0760 **Horse Feeds.** Feed purchased for breeding stock is exempt since the product (foals) is sold in the regular course of business. If horses are raced, feed is taxable. A liveryman is a consumer unless he clearly retails feed to his customers. In such case, he can buy such feed under a feed exemption certificate. 4/6/64.

110.0780 **Horse Feeds.** The sale of feed for work horses used principally in plowing for cultivation of food products for human consumption does not come within the exemption of Regulation 1587. Horse flesh does not ordinarily constitute food for human consumption and since the owners of the work horses are using the horses rather than breeding them for sale, the feed exemption does not apply. 4/15/54.

110.0800 **Horse Boarding Ranch.** Feed sold to a horse breeding ranch which boards breeding stock for other persons, charging them a monthly amount for all boarding services including feed consumed, may not be purchased under a resale certificate. The ranch does not retail the feed to its customers; rather, it consumes the necessary amount of feed expended in providing the total service. 8/9/65.

ANIMAL LIFE AND FEED (Contd.)

110.0820 **Hylage Forage Saver.** Hylage forage saver qualifies as an exempt feed under Section 6358 and Regulation 1587. 4/17/68.

110.0880 **"Kalkar Grit,"** a substitute for grit and shell, provides substantial quantities of soluble calcium as a dietary supplement for the animals to which it is fed, and is an exempt animal feed. 6/28/54.

110.0900 **Kelp** fed to poultry or animals is regarded as a feed within the meaning of Regulation 1587. 8/11/50.

110.0920 **Litter.** Ground manure sold to chicken raisers and spread in chicken houses as a litter and partially consumed by the chickens, does not qualify as an exempt feed. Primary use of the product is for bedding purposes, the consumption thereof by the chickens being purely incidental. 4/13/54.

110.0940 **"Medicated Feeds."** When poultry and animal feeds are fortified with drugs or other non-nutritive ingredients which are added for the purpose of preventing and controlling disease, the feeds will not lose their exempt status. On the other hand, if the mixture is labeled and sold for the specific treatment or cure of disease, the product will not be regarded as a feed. 4/26/51.

(Note: Changes to drugs and medicines in section 6358.4, operative April 1, 1996, and subdivision (e) of section 6358, operative January 1, 1997.) (Am. 2000–2).

110.0960 **"Medicated Feeds."** Sale of product is wholly taxable or wholly exempt depending upon its classification as a feed or medicine for sales tax purposes. 1/9/51.

(Note: Changes to drugs and medicines in section 6358.4, operative April 1, 1996, and subdivision (e) of section 6358, operative January 1, 1997.) (Am. 2000–2).

110.1020 **Monkey Chow.** Monkey chow fed to monkeys to be used for laboratory purposes is not exempt. 12/7/65.

110.1070 **Pigeon Feed.** Sale of feed for racing pigeons is exempt from tax because pigeons (squab) are animals of a kind the products of which ordinarily constitute food for human consumption. 7/21/80.

110.1100 **Pomace.** The sale of pomace as a feed for cattle is exempt from tax. 5/18/56.

110.1112 **Presumption of Feed Exemption.** Regulation 1587 provides that, in the absence of evidence to the contrary, it is presumed that sellers of feed which is of a kind ordinarily used only in the production of meat, dairy, or poultry products for human consumption are making exempt sales of such feed for use in the production of meat, dairy, or poultry products for human consumption. Such sellers, therefore, generally need not secure feed exemption certificates. The presumption of exemption also applies with respect to sales in small units (two standard sacks of grain or less and/or four bales of hay or less) of feed of a kind customarily used either for food production or other purposes (feeding work

ANIMAL LIFE AND FEED (Contd.)

stock), or with respect to sales of feed that is specifically labeled by the manufacturer for food animals. This presumption of exemption does not extend to sales of other feeds even though the particular type of feed may be used 80% of the time to feed animal life of a kind used for human consumption. 7/14/81. (Am. 2000–2).

110.1118 **Pro-Serve and Pro-Serve II.** Pro-serve is a silage treatment which preserves nutrients in the silage so that animals get the most from the food. When sold to be used as an ingredient of the silage as feed for animal life of a kind the products of which constitute food for human consumption, or to be resold in the regular course of business, it is an exempt feed.

Pro-Serve II is a forage treatment which is added to hay to allow the hay to be baled at higher moisture levels thereby making the hay more nutritious and palatable. It is used in producing hay and not for the purpose of incorporation. Accordingly, sales of Pro-serve II are subject to tax 10/11/89.

110.1160 **Senvita Minerals.** The fact that ''Senvita Minerals'' is normally mixed with other materials such as ground feeds does not necessarily mean that it is a drug or antibiotic. The contents of the product as well as the manufacturer's feeding directions indicate that the product should be considered an exempt feed. 5/8/57.

110.1180 **Silogerm** is an exempt feed. 2/19/52.

110.1220 **"Swift's Mineral Supplement"** held to feed within meaning of Regulation 1587. 3/20/50.

110.1250 **Unistat** is an exempt feed. 2/27/61.

110.1280 **Vitamins.** Vitamins sold for the purpose of and in a form to supply the normal nutritional requirements of animal life constitute animal feeds. Where, however, the vitamins are sold for use as and in the form of a dosage for the purpose of overcoming a specific deficiency, they are to be regarded as drugs. 12/7/51.

(Note: Changes to drugs and medicines in section 6358.4, operative April 1, 1996, and subdivision (e) of section 6358, operative January 1, 1997.) (Am. 2000–2).

110.1300 **Vimin 64, Animals and Feed.** Vimin 64, consisting of dolomite and kelp and sold for use as a mineral additive to salt and feed consumed by range and dairy cattle, qualifies as an exempt feed. 8/15/66.

110.1320 **"Vitagold Coccidiosis Control Mash"** is primarily a medication and is not an exempt feed. 1/14/57.

(Note: Changes to drugs and medicines in section 6358.4, operative April 1, 1996, and subdivision (e) of section 6358, operative January 1, 1997.) (Am. 2000–2).

ANIMAL LIFE AND FEED (Contd.)

110.1340 **"Vitagold" Products.** "Vitagold Broiler-Fryer Mash," "Vitagold Bunny-Ade Pellets," "Vitagold Turkey Pre-Starter" and "Vitagold Chlortetracycline Poultry Mix," are all exempt feeds. 1/14/57.

110.1360 **Vitamin D3, Vitamin B-12, Baciform, Dupont's Two-Sixty-Two Feed Compound, and By-500,** incorporated into feeds, are intended to provide nutrition, and therefore, are exempt feeds. 12/7/51.

110.1380 **Vit-a-Way Livestock Fortifier** is an exempt feed. 3/20/52.

110.1420 **Yeast,** sales of, for use as a poultry feed, are exempt. 9/24/51.

ARTISTS
See Advertising Agencies, Commercial Artists and Designers.

ASSEMBLY
See Producing, Fabricating and Processing Property Furnished by Consumers—General Rules.

ASSUMPTION OF INDEBTEDNESS
See Gross Receipts.

115.0000 AUCTIONEERS—Regulation 1565
United States, auctioneers employed by, see also United States, Sales by—"Surplus Property."

115.0010 **Auction Sales—Buyer's Premium.** A seller consigns goods for sale at auction, after agreeing to pay the auctioneer a certain percentage of the sale price. The auctioneer also announces to the buying audience that a 10% buyer's premium will be added to the purchase (bid) price, which will be retained by the auctioneer. If a person is the successful buyer of an item for a bid of $100, the buyer will pay to the auctioneer $110. The gross receipts from the sale include the buyer's premium. Tax applies to the entire $110 paid by the buyer to the auctioneer. 3/16/88.

115.0012 **Auctioneer's Place of Sale.** An auctioneer is not required to obtain a separate subpermit for all auction locations at which it will be making sales for temporary periods of less than thirty days. The local tax on the auctioneer's sale are, therefore, placed in countywide unallocated pool for the county in which the auction is held. 4/30/91.

(Note: Statutory changes to Regulation 1802, effective July 1, 1996.)

115.0015 **Collection of Use Tax.** An out-of-state auctioneer who is engaged in business in California, is required to collect the use tax when it holds auctions outside the state and undertakes to ship the goods to the purchaser in California. 1/27/87.

115.0020 **Furnished Houses.** Real estate auctioneers selling furnished houses are retailers of the personal property contained therein. They must secure sellers'

permits and pay tax on the selling price of the personal property included with the house. If a lump-sum charge is made, the tax must be paid on the fair retail value of the personal property. 1/25/65.

115.0025 **Internet Auctioneer.** A California firm advertises on its website, which it administers from its California location, that it is bonded as an auctioneer in California and states in its contracts with the owners of tangible personal property that it is in the business of selling equipment at auction. The firm advertises and holds itself out as a person available to engage in the asking for, recognition of, and acceptance of offers to purchase equipment at an online auction. The auction is conducted by computer-generated exchanges between the firm and its audience, consisting of a two-week preview period in which a picture and/or description of available equipment is displayed on the firm's Web site, followed by a three-day bid period during which the three top bids are continuously displayed on the Web site and any interested viewer may bid above the preceding highest bid. At the end of three days, the highest bid is accepted. Under its contracts with the owner and buyer of the equipment, the firm has both the power to bind the owner and buyer of the property to the sale, and the power to transfer title to the property.

The firm is an auctioneer and, thus, a retailer of equipment sold by it at auction on the Internet. The firm must report sales tax from the retail sales of property shipped from a California location of the owner of the equipment to a California location of the buyer of the equipment. Since the firm maintains an office in this state, it is a retailer engaged in business in California. As such, the firm must collect and remit the use tax from California purchasers who make retail purchases of items shipped from the out-of-state location of the owner to California. 11/26/97. (M99–2).

115.0040 **Out-of-State Auctioneer—Collection of Use Tax.** An auctioneer's principal place of business is in New York. The auctioneer is considering opening an office in California, staffing it with employees who may:

Contact California residents who may be prospective sellers of art objects, and invite them to include such objects in auction sales.

Contact California residents who may be prospective buyers of art objects at the auctioneer's New York auction sales, and notify them of the time and place such objects will be available for inspection. Information regarding such object may also be provided, upon request.

Make appraisals of art objects for insurance or probate purposes. These objects would not be sold at auction by auctioneer.

Property sold by the auctioneer to a California resident would be delivered by the auctioneer to the resident at the place of auction or to a common carrier selected by the resident. Under these circumstances, some residents might not bring property they had purchased from the auctioneer to California.

If the auctioneer opens an office in California and if its employees solicit or take orders for art objects, it will be a retailer engaged in business in this state and it will be required to collect California use tax on its sales of property purchased

AUCTIONEERS (Contd.)

for storage, use, or other consumption in California which occur at its auction conducted outside California to the extent the property sold is delivered within California.

On the other hand, the auctioneer will not be required to collect California use tax on its sales of property purchased for storage, use or other consumption in California which occurs at its auction conducted outside California where the property purchased is delivered to residents at the place of auction or to a common carrier selected by residents where the auctioneer is not required by the (auction) contract of sale to provide for delivery in California, or delivery to California residents is at points outside of California. 3/25/70.

115.0050 **Out-of-State Sales.** At the time of sale, the auctioneer did not have proof of a condition or requirement to ship or deliver the property to an out-of-state location. In instances where the auctioneer has a bill of lading showing the property was shipped from the auction site, or other place where the auctioneer had control of the property, directly to an out-of-state point by common contract carrier, the documents (bill of lading) confirming the out-of-state shipment will be accepted as evidence of meeting the ''pursuant to the contract of sale'' requirement of Regulation 1620(a)(3)(B). 6/8/88; 5/20/96.

115.0060 **Partner Buys Back.** A partnership sold several horses through an auctioneer. The horses were purchased by one of the partners who had a one third interest in the partnership.

In this case, the partnership owned the horses which were sold at auction, and assigned the right to sell them to the auctioneer. An individual purchased the horses which had previously belonged to the partnership. Therefore, there was a change of ownership, and sales tax is owed on the entire sales price, not on just two thirds. 1/7/94.

115.0090 **Vehicle Not Requiring Registration.** Sales by auctioneers of vehicles that are not required to be registered under the Vehicle Code, i.e., to servicemen who will register them in their home state or to out-of-state residents who will remove the vehicles on one-way trip permits are subject to sales tax notwithstanding the fact that the auctioneer is not a registered dealer, manufacturer, or dismantler. 12/23/71.

120.0000 AUTOMATIC DATA PROCESSING SERVICES AND EQUIPMENT—Regulation 1502

See also Computers, Programs, and Data Processing; Mailing Lists and Services.

(a) IN GENERAL

120.0004 **Access to Database.** Taxpayer is in the business of selling access to a financial information database. The taxpayer provides access to the database by installing a prewritten computer program on its customers' computer, and title and possession of the prewritten computer program remains with the taxpayer at all times. Taxpayer's customers do not have physical possession of the storage media containing the prewritten computer program at any time and the customers

AUTOMATIC DATA PROCESSING, ETC. (Contd.)

do not have control of their computers while the prewritten program is being installed on the customer's computers. If customers should cancel the service, the software program is deleted from their computers. Under these circumstances, tax does not apply to the amount charged by the taxpayer to its customers for the right to access the financial information database. 12/31/96.

120.0005 **Accessing of Database.** An out-of-state person requested information regarding the application of sales and use tax to the following transactions:

(1) A resident of California uses the computer and calls an on-line data service. The individual searches the database, reviews the results on the screen and takes handwritten notes. Assuming the database provider charges for the search, is any sales or use tax due?

(2) The access and search are identical to (1) except that the results are downloaded into the individual's local terminal and either printed out on the individual's printer or saved to a diskette. Is any sales or use tax due?

In both transactions, the database operator provides electrical signals which contains the information sought by the user. Since no tangible personal property is transferred to the user and the database operator performs no fabrication of tangible personal property supplied by the user, no sales or use tax applies.

(3) The access and search are identical to (1) except that the completed information is printed out by the database operator and mailed to the individual. Is any sales or use tax due? Does it matter if the database provider resides in or out of state?

Where a database operator provides information in response to the unique request for information from the user, the operator is providing a service. Since the operator is regarded as the consumer of that property, neither sales nor use tax applies to the transfer. If the operator consumes the property in California, use tax applies to the operator's use of that property measured by the operator's cost of the property unless the operator has already paid sales tax reimbursement to its vendor when purchasing that property.

(4) Does the taxability of these transactions change if the state resident dials (a) an 800 number, (b) an out-of-state number, or (c) an in-state number?

Since these transactions are not sales, this question is not relevant. However, this factor would not alter whether a transaction is subject to tax or not. 9/21/90.

120.0006 **Address Labels.** A taxpayer maintains customer address files for clients. When requested by its clients, the taxpayer prints address labels and delivers them to the clients. A flat monthly charge is made for maintaining and updating files and a separate charge is made for each label printed. On occasion, clients request file printouts for which the taxpayer makes a charge. Tax applies only to the charge for the printouts. They are not regarded as mailing lists under Sales and Use Tax Regulation 1504. Under Regulation 1502, charges for file maintenance and printing address labels are not taxable. 6/9/82.

120.0008 **Annual On-Line Database Contract with Transfer of Publications.** A taxpayer who is an information research firm offers an annual license to an

AUTOMATIC DATA PROCESSING, ETC. (Contd.)

Internet-based financial database. The database resides in a server at the taxpayer's premises, and licensees access it via their web browsers. The annual license fee is $15,500 and includes two publications. There is no separate charge for the publications included with the license but when they are sold separately, the subscription price of these two (together) is $2,995 ($2,495 and $795 for each publication when sold by itself). Also included with the license is the choice of two off-the-shelf reports which sell separately for $750.

The annual license fee is both a contract for the providing of a service (i.e., access to the Internet database) and a contract for the sale of tangible personal property (i.e., the publications and the off-the-shelf reports). As such, tax does not apply to the charges solely for access to the Internet database, which equals $11,755 [$15,500–$3,745 (for periodicals and reports)]. Tax applies to the charges for the publications unless the sale qualifies for the periodical exemption. Finally, tax applies to the gross receipts from the sale of the off-the-shelf reports because the reports are neither periodicals nor custom reports. 9/18/97. (M98–3).

120.0009 **Bundled Hardware and Software Maintenance Contract (Optional).** A contract for optional hardware maintenance is not a contract for the sale of tangible personal property and no sales or use tax applies to the charge. On the other hand, a contract for software maintenance under which the customer will receive updates or error corrections on tangible media is a contract for the sale of tangible personal property. Furthermore, if a software maintenance contract includes a mandatory charge for consultation, that charge is included in the measure of tax from the sale of the software maintenance contract. Therefore, when a bundled contract includes a software maintenance portion and a hardware maintenance portion, the charge for the hardware portion of the contract is nontaxable. The contract should be prorated between the taxable software maintenance portion and the nontaxable hardware maintenance portion of the contract. 7/15/96.

120.0013 **Charges Associated with Computer Software.** Information was requested regarding the application of sales tax to the following:

(1) Consultations with clients and training seminars held on site at offices.

The charge for merely consulting or providing seminars, without the transfer of tangible personal property in connection with consultation or training is nontaxable.

(2) A monthly charge billed to the clients for telephone support and periodic updates of software.

The charge for a software maintenance contract, which provides updates and future releases, is a contract for the sale of tangible personal property and is taxable. If maintenance cannot be acquired by the client without telephone support, the telephone support (consultation) is part of the gross receipts and is subject to tax. (See Regulation 1502.)

(3) Special programming that is done in office and sent to clients via the phone lines using a modem.

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If information is provided to a client by remote telephone modem, the charge is nontaxable. 3/12/92.

120.0014 **Charges for Code to Access Information on CD.** A taxpayer creates a database of technical information on CD. The CD is then marketed through distributors and directly to consumers. The CD contains information covering several different applications. Usually, limited access to the data on the CD is sold to consumers by the distributors, but the consumer must contact the taxpayer to obtain a code to access that information. When the consumer contacts the taxpayer to obtain the access code, the consumer is told of additional information on the CD that is available for an additional charge. If the customer agrees to pay this fee, the taxpayer provides no tangible personal property, but rather provides only access codes that will unlock the additional information on the CD that would otherwise be inaccessible to the customer.

The taxpayer owes sales tax on its charge to the consumer for access to the additional information on the CD whether the charge is made to a customer who purchased the CD directly from the taxpayer or to a customer who purchased the CD from a distributor. 9/5/96.

120.0015 **Charges Related to Both Installation and Hardware.** The taxpayer sells computer hardware and software, and charges for related services such as hotline support, miscellaneous supplies, repair parts, employee travel expenses for site preparation and installation of hardware and software.

Sales tax applies to the retail sales of hardware, miscellaneous supplies, repair parts, and pre-written and sub-licensed software. Sales tax also applies if the client is required to purchase a maintenance contract or the hotline support service. Separately stated travel and subsistence expenses should be allocated between the taxable charges for site preparation and the exempt charges for installation of hardware and software. Charges for testing a pre-written program on the client's computer is part of the installation of the program and are exempt. 6/9/89.

120.0015.800 **Lease of Software.** Software is transferred by telecommunication from disk media owned by the transferor to tape media owned by the transferee, with the transferor retaining ownership and possession of the disk except that by contractual agreement the disk was placed in escrow for five years. The transferee is allowed access to the disk upon request for the purpose of verifying the accuracy of the software. Also, by the same agreement, the transferor agrees to not remove the disk from escrow, use or make copies of the disk, or permit any other person to have access to the disk.

The agreement has the characteristics of a lease because the transferee has effective possession, use, and control of the disk during the five year period. The transferee is liable for use tax on the payment for the transfer and the tax must be collected by the transferor and remitted to the Board. 8/1/86.

120.0018 **Charges for Updating Mailing.** Company A is a provider of automatic data processing services and maintains mailing lists for clients on its

AUTOMATIC DATA PROCESSING, ETC. (Contd.)

automatic data processing equipment. When Company A maintains a mailing list for a client and prepares through its automatic data processing equipment a single galley-bookrun of names and addresses to be updated by the client and returned to Company A for use in updating its mailing list for that client, Company A's separately stated charges to the client for that galley-bookrun are not subject to sales or use tax. 1/18/77.

120.0023 **Computer Assisted Design (CAD) Services.** A customer supplies drawings, blueprints, sketches, and written descriptions and, in return, receives a disk produced by the use of CAD software. The information on that disk is expressed mathematically rather than graphically. This constitutes the type of nontaxable service described in Regulation 1502(d)(5)(A) because the person furnishing the disk was required to manually edit, check, and/or otherwise prepare composite drawings, detail drawing, or layered drawings from the information supplied by the customer. The results are fundamentally different from copying, optical scanning, or blueprinting manual. Since the customer receives the information in the form of mathematical data, the customer can manipulate that data through the use of its own computer programs. The service remains nontaxable even if a pen plotted drawing was supplied together with the CAD data on the disk. 12/20/88.

120.0030 **Computer Data Bases.** A client contacts the taxpayer with the medical name of the client's ailment. The client commonly questions a diagnosis their doctor has given. The taxpayer researches the most current medical information on the ailment in a computer data base and sends the client a computer printout discussing the ailment. The charge for such research and computer printout is for a nontaxable service. The true object of the transaction is medical diagnosis. The computer printout is the means to transmit the product of the service and is only incidental to providing the service of medical research and diagnosis. The charges for such a service are not subject to tax. 7/26/88.

120.0040 **Computer Forms Printer.** Where an automatic data processing service bureau reproduces a customer's output on a Computer Forms Printer, the reproduction charges are subject to sales tax because the data are not transferred by computer program and no new information is developed. If the data is transferred by computer program and new information is developed, the processing is not taxable because the object of the contract is service. The nontaxability of the basic processing of the data will not be affected by the use of the Computer Forms Printer to reproduce extra copies. If the computer firm cannot identify the separately taxable portion of the charges for the processing contract, all charges are taxable. 2/5/70.

120.0042 **Computer-generated Output (CAD).** Taxpayer does computer aided drafting (CAD) ''services'' by redrawing of paper drafting documents such as architectural blueprints or electrical schematics which become digital computer files of information. Taxpayer recreates the drawing so as to duplicate its every dimension and text or data unit. In recreating the drawing certain processes are automatically performed while other activities are done manually by the operator.

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The original drawing document and the electronic file are then returned to the customer with the electronic file stored on a floppy disc.

Computer-generated output of redrawn architectural blueprints is subject to tax. (Sales and Use Tax Regulation 1502.(c)(4).) 12/13/91.

120.0048 **Computer Program Training Materials.** A taxpayer develops a training course for a software manufacturer for a program not yet on the market. The course materials include a disk containing an instructor's guide, a participant workbook disk, a disk containing overheads, and a disk containing sample files. The taxpayer transfers all of its reproduction rights to the course materials to the software manufacturer. The software manufacturer edits the materials and markets the training course under its own name. The sale of the disks containing word processed disk copy is not subject to tax as it is similar to an author's original manuscript containing the expression of an idea. The sale of the graphic material, whether on disk or on hard copy, is comparable to the sale of artwork for reproduction or display and is, therefore, taxable. 6/14/90.

120.0050 **Computer Services.** A person operates an on-line service for the buying and selling of consulting services, software and information. The ''service'' links information sellers with the information buyers through the seller's and buyer's personal computers and a host computer system maintained in California. The ''service's'' contact with this state consists primarily of mailings, advertisements in magazines and telephone connections. Periodic appearances may be made at conventions, trade shows and user's group meetings where free access and demonstration software may be given away.

Both buyers and sellers access the system using their own computers and a modem. Information is delivered electronically over the telephone line without the transfer of tangible personal property. The ''service'' provides a forum for the buyer and seller to meet. The ''service'' derives its revenue by charging transaction fees, connection charges, one-time new account sign-up fees, monthly service fees and storage fees. The ''service'' also is involved in collecting from the buyer and paying the seller.

The activities of the ''service'' qualify the ''service'' as a retailer, by maintaining the host computer in California, the ''service'' occupies a ''place of business in this state,'' section 6203.

The ''seller's'' charges for (1) consulting services sent electronically through the computer, (2) prewritten text sold electronically through the computer, and (3) other information, such as computer software graphics, sound and template, are not subject to tax provided that no tangible personal property is sent to the buyer. In addition, tax does not apply to the transfer of information by electronic telecommunications from a remote location, if there is no tangible personal property sent to the buyer. If the person described as the ''seller'' sends a hard copy of information to the buyer, the entire charge would be subject to sales or use tax.

Depending on the facts of the transaction, the person operating the service may well be the retailer responsible for payment of any sales tax or collection of any use tax on the transaction. 12/9/92.

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120.0052 **Computer Software—License to Use and Sell.** A corporation enters into a contract for the sale of software which provides for a $300,000.00 payment plus a license fee for the right to incorporate the software into custom software to be developed and sold by the purchaser. The contract also allows the purchaser to use the program for ''purposes of processing customer data and for marketing.''

The amount of the license fees attributable to the ''right to incorporate'' and resell the software, is excludable from the measure of tax pursuant to Regulation 1502 (f)(1)(B). The portion of the $300,000 fee which is attributable to the customer's right to use the software is subject to tax, unless the software sold by the corporation is a ''custom computer program.'' 6/12/91.

120.0053 **Computer Software Programs.** A company develops applications and systems software programs. The software, which is sold to original equipment manufacturers, (OEM) consists of two components: a ''kernel'' which is identical for all users regardless of the hardware, and a device-implementation portion that is unique for each type of hardware upon which the program will operate. The company licenses this software to OEM's under license agreements allowing sale of the software along with the hardware the OEM's sell to their customers. The company usually develops the entire kernel. The device—implementation is developed either entirely by the company, entirely by the OEM's, or jointly. Both the kernel and the device implementation, if any provided by the company may be in source program and/or object program format. The charge for this company's software is not separately stated in the charge made by the OEM's to their customers. The OEM's pay the company the following fees:

(1) royalties related to the hardware items containing the software sold or distributed by the OEM's;

(2) a non-recurring engineering fee for services in developing a device—implementation;

(3) a source license fee when the company provides some or all of its software in source;

(4) a fee for distribution to end users of documentation provided by the company in excess of a certain number of free copies.

Regardless of the manner or formula for determining the royalty payments and license fees and regardless of whether the copyright program is transferred by way of a source program and/or an object program format, no sales or use tax applies. This is also true regardless of whether it is delivered in the form of systems software or hard-wired board which would be inserted into the OEM's hardware. Neither sales nor use tax applies to non-recurring engineering fees with respect to services rendered by the company to develop software which is not part of a sale of tangible personal property. In addition, neither sales nor use tax applies to fees for software updates provided by the company to an OEM under a license agreement when a copyright attaches to those updates and they are transferred solely for the OEM to sell copies of those updates. 9/21/90; 1/17/91.

AUTOMATIC DATA PROCESSING, ETC. (Contd.)

120.0054 **Computer Terminal with Analysis of Electrocardiograms.** A lessor rents computer terminals to physicians for use in their offices. The equipment is used to provide analysis of electrocardiograms (ECGs) performed in the physician's office. The terminal is described as a three channel, ten wire, twelve lead ECG instrument which connects directly to the patient to take readings on the twelve leads automatically. The patient's age, weight, and other data are entered via a keyboard and included on the printed report. The terminal is connected via telephone lines to the lessor's central computer. The terminal automatically dials the computer and transmits the collected ECG data. In seconds, the computer responds and the terminal prints a complete analysis of the ECG. In addition, a board-certified cardiologist is on call at the computer site to review and assist in interpreting the report. A physician can call the computer site and discuss the report with the specialist. The lessor charges a flat amount per month for the equipment. In addition, a separate charge is made for each time that the equipment is used to provide an ECG analysis. No charge is made for telephone consultations with the cardiologist.

The separately stated amounts charged for ECG analysis are service fees and, therefore, not subject to tax. Monthly charges for the equipment are lease receipts subject to tax unless leased in substantially the same form as acquired and tax has been paid at the time of acquisition. 1/17/83.

120.0055 **Computer Tutorials or Promotional Programs.** A taxpayer prepares educational or promotional tutorials on electronic media for operation on a computer. No other tangible personal property is transferred. The taxpayer contracts for the ''graphic art'' to be included in the tutorial. The ''graphic art'' may include the production of preliminary art, finished art, consultation and research, supervision, motion picture production, photography and videotaping.

The charges to the taxpayer for the graphic art are subject to tax. The graphic artist may avail itself to the exclusion for preliminary art provided the criteria in Regulation 1540 are followed.

A motion picture is not ''graphic art'' as contemplated by Regulation 1540. A transfer of a ''qualified motion picture'' to the person for use in producing a computer program, is not subject to tax; rather the person producing the ''qualified motion picture'' is the consumer. 1/27/92.

120.0060 **Computer Work.** If the product of a computer operation consists simply of punchcards or other tangible property prepared from data supplied by the customer, the operation constitutes a processing of personal property and is taxable as a sale under Section 6006(b). However, if the operation involves the development of information or evaluation of data so that the operator of the computers is actually creating ideas, information or concepts, then he would be performing a service and would be considered the consumer rather than the retailer of cards or other tangible property delivered to customers. 9/28/66.

120.0100 **Computer Work.** When a computer center enters a contract which provides that the center will keypunch data from source documents received from a client, verify the data, correct it, feed the material into a computer, and produce

reports therefrom, the charges are not subject to tax because the contract is a service contract. However, where a computer service center enters into a contract solely to keypunch or keypunch and verify the data, the charges are taxable since they constitute charges for fabrication and the sale of tangible personal property. Similarly, charges for solely reproducing punched cards, print outs in the form of printed labels or multiple copies of reports are taxable. 3/20/68.

120.0100.500 **Consulting Services.** A taxpayer is engaged in the business of providing consulting services in connection with computers and computer applications. These services include after the sale consulting with the purchasers of the equipment and are related to business needs and applications of the purchased computers and software, training the client's staff, troubleshooting the equipment and system for the first 90 days. The agreement for the initial 90-day period also involves bringing the client's business entity on-line into a fully computerized working system. The taxpayer states that it did not, and would not, provide hardware and software to any client to whom it extends a proposal unless the client also agreed to that portion of the proposal requiring the client to enter into a simultaneous support agreement. Two separate written agreements are issued (1) for the sale of computer software and hardware, and (2) for consulting, maintenance, training and installation services. The company believes that bifurcation of the client's acceptance of a unitary bid into two separate written agreements avoids inclusion of gross receipts under the support services agreement in the measure of tax even when both agreements are included on the same invoice.

A contract must be viewed in its entirety including the offer, any acceptance(s), and consideration passing between the parties. The Agreement for Purchase of Equipment and the Agreement for Purchase of Support Services memorialize mutually contingent contractual terms that are the subject of one proposal. The taxpayer's admission that it would never provide hardware and software unless its client also agreed to accept the support services offered in the bid demonstrates that the bid is a nonseverable offer which is capable of acceptance only by agreeing to all terms. The taxpayer's statement that the offer or proposal was not severable made acceptance of the resulting contract all-or-nothing. Whether reduced to one writing or two, the company offered a nonseverable contract to provide services in connection with the sale of tangible personal property. Therefore, only that portion of the support services contract attributable to installation labor in connection with the sale of tangible personal property is excludable from gross receipts. 2/28/90.

120.0101 **Copyright Royalties.** Tax does not apply to a transfer of a copyrighted program to a customer for the purpose of transferring the federal copyright interest, where the customer's payment of license fees or royalties is for the right to reproduce and distribute the program for a consideration to third parties. However, site license fees and other end user fees paid by the customer remain taxable. (Regulation 1502 (f)(1)(B).) 8/23/88.

120.0101.250 **Copyrights and Prewritten Programs.** Corporation A sold an entire division to Corporation B. Included in the sale were two canned software

programs. Corporation B obtained title along with the copyright interest in the programs. Also, as a part of the agreement, Corporation B granted back to Corporation A a license to copy and sublicense one of the programs for use only in the mechanical segment of the printed circuit board market. In addition, Corporation B licensed back to Corporation A a right to use the same program for Corporation A's internal use only.

Under Regulation 1502(f)(1)(B), the transfer of the copyright interests in these programs in the Asset Purchase Agreement is nontaxable. Corporation A transferred the copyright interest in these programs to Corporation B so that Corporation B could publish and distribute copies of the programs for consideration to third parties, and the transfer of the copyright is not limited to copying the programs for Corporation B's own internal use. In this situation, the amounts Corporation B paid for these copyrighted programs were not for site licensing or other end user fee amounts, which would have been includable in the measure of tax under Regulation 1502(f)(1)(B).

With respect to Corporation A acquiring from Corporation B a license to use the source code for one of the programs for internal use, this is also nontaxable because there was no transfer of tangible personal property from Corporation B to Corporation A. Instead, Corporation A merely retained certain rights to the program when it transferred the program to Corporation B. 4/22/88. (Am. 2002–3).

120.0101.500 **Database Access.** A taxpayer gathers data from the hospital industry, that is, room usage, rates, etc. The taxpayer sorts, compiles, and stores the information on its computer. Computer printouts are prepared in graph form showing trends of a particular hospital or hospitals. The graphs are then provided to subscribers. A subscriber might want information regarding only itself, or it might want information on all the hospitals in the area. The furnishing of graphs is regarded as a sale of tangible personal property, not as the providing of a service. The graphs do not constitute exempt periodicals because they do not include any text. 8/25/82.

120.0101.800 **Data Information Services—Internet.** A company provides weather data to its customers. The customers access the information by logging onto the company's service through the Internet. The company does not transfer any tangible personal property to its customers. No sales tax applies to its charges. 7/10/96.

120.0102 **Data Processing and Data Entry.** A taxpayer requested information regarding the application of tax to the following cases:

(1) Keying of customer's paper documents and providing magnetic media (diskette or computer tape). Custom program services are necessary to allow the data entry to commence.

Charges for data entry are taxable whether the storage media are furnished by the customer or by the data processing firm. When programming is performed for use in performing taxable data entry, the charge for programming is taxable. The

programming service is an expense in fabricating the magnetic media desired. Section 6012 prohibits the deduction of these ''service costs.''

(2) Same as (1) except the data is transmitted over telephone lines, using a ''modem.''

Provided that tangible personal property is not transferred, tax does not apply to the charge if the transfer of information is by remote telecommunication from the data processing firm to or through the purchaser's computer.

(3) Same as (1) except that instead of magnetic media, an address list only is provided.

If a mailing list is created from documents provided by a customer by using a typewriter or word processor, tax does not apply to the charge for the original document and carbon copies produced simultaneously with the original. Tax does apply to charges for producing multiple copies of the document.

(4) Same as (3) but in addition to the address list, magnetic media is also provided.

Since magnetic media is transferred to the customer, the entire charge is taxable regardless that an address list is also provided to the customer. 4/15/92.

(Effective 1/1/94, due to a statutory change, "mailing lists" also includes a magnetic tape or similar device used to produce written or printed names and addresses by electronic or mechanical means. Therefore, magnetic tape mailing lists are exempt where a contract restricts the purchaser to a single use of the mailing list.)

120.0103 **Data Processing Services.** A company is engaged in selling turnkey computer packages with the use of the software programs being licensed to the user with no privileges of reselling the software program. Sales tax is charged on the entire package including both hardware and software and on charges for any subsequent modifications or enhancements made to the software program after the initial installation. It was asked whether sales tax applies to the following transactions:

(1) (a) Repair to software programs which have become garbled or damaged due to environmental conditions. The repair only restores the program to its original condition and does not improve or modify it.

(b) Similar repairs to data files.

Assuming the ''repair'' is accomplished by furnishing the customer a new disk or tape on which is recorded the ''repaired'' program or data file, for which a charge is made, both types of transactions are subject to tax. The tax applies for the same reason that it would apply to the sale of a duplicate disk or tape on which has been recorded a program or data file. It is simply the transfer for a consideration of tangible personal property and constitutes a taxable sale.

(2) The enlargement of a data file due to a customer's growth where there is no change in, or addition to, existing programs.

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Assuming that ''enlargement'' means that for a fee the customer is provided a new disk or tape with the enlarged data file recorded on it, the transaction is subject to sales tax for the same reasons set forth in 1 above. 5/18/81.

120.0104 **Database.** A firm is engaged in the business of providing a computer database service. The firm contracts with a vendor who has a mainframe computer to store its database in the computer. The firm delivers software to its customers that enables the customer to connect to the database. The customer is charged based on time usage, access fees, and database utilized.

Assuming that title to the software is transferred to the customer or it was developed in-house and licensed for use, the transfer of the software is subject to tax as a ''sale.'' The firm must make a fair and reasonable allocation of its charges between the charge for database access and the software. 1/24/90.

120.0105 **Design of Circuit Board.** A designer of printed circuit boards uses computer and computer aided design (''CAD'') software to design the layout of electronic components on a printed circuit board (''PCB'') from drawings provided by its customers. Information from the drawings and other reference materials is entered on the type, size and electronic characteristics of the circuit components onto the CAD software data base.

The software program is used to manipulate the data to generate the optimum design for the PCB. When completed, the design information is transferred to the customer:

(1) via a computer modem over telephone lines or in the form of computer data on a tape cartridge or floppy disk, and

(2) in the form of fabrication and assembly drawings on vellum.

The designer issues an invoice for the design and a separate charge for photoplots. No separate charge is made for tape cartridges, floppy disks or vellum. Given this information, tax does not apply to:

(1) charges for tangible representations of the design except where the drawings are suitable for use as camera-ready art, and

(2) the transfer of information by modem as this is not the transfer of tangible personal property.

However, tax does apply to:

(1) the sale of manufacturing aids used in the production of the PCB such as photoplots, and

(2) the sale of photoplots whether the designer develops the design or the customer develops the design even if the customer were to provide the material the designer uses to create the photoplots. 8/30/93.

120.0106 **Dial-Up Access to Computer Database.** A company offers subscriptions to a dial-up computer database service. Subscribers gain access by using personal computers and modems. As such, they have on-screen access to the statistical information contained in the database, and can issue commands to

retrieve and manipulate data in order to make reports. The subscribers can then either view reports on-screen or download the reports to their PC's storage and printing.

Provided all of the reports received by the subscribers are sent over the telephone lines and any hard copies generated are printed by the subscribers themselves, the company's charge for the subscriptions is not subject to tax. Electronic transmissions of information that do not involve the transfer of tangible personal property are not taxable. 7/17/92.

120.0107 **Driver Source Code.** Company A is planning to contract the development of a software product from Company B. Company B will purchase an unlimited source code for Company A from the manufacturer, modify the driver source code, and deliver the original and modified source to Company A at project completion.

It appears that Company B merely acts as an agent on behalf of Company A in acquiring the program from the manufacturer. If this is true, the relevant transaction is the transfer of the program from the manufacturer to Company A. Tax does not apply to the amount paid for the license or royalties by Company A to the manufacturer for the transfer of the program to Company A if the transfer is to provide Company A with the right to reproduce and copy a program to which a federal copyright attaches in order for Company A to publish and distribute the program regardless that Company A has Company B modify the program to be compatible with Company A's application. 8/31/92.

120.0107.800 **Electronically Delivered Graphics.** A publishing company located in California provides a monthly sample of new clip art to its customers on the Internet for a $50 a month fee. Customers may also (1) subscribe to a monthly clip art diskette which is mailed directly to the customer's place of business or (2) subscribe to an electronic clip art newsletter which is available on the Internet and sent to the customer via e-mail.

Sales tax applies to the sale of graphics in the form of tangible personal property. Therefore, the sale of the artwork on the diskette is subject to sales tax since it is tangible personal property. Sales or use tax does not apply to the transfer of graphics by electronic transmissions. For example, the art work is sent to the customer by modem or posted on an electronic bulletin board and the recipient does not receive any tangible personal property, the transaction is not a sale subject to tax. A charge solely for on-line access is not taxable because such on-line access does not involve the transfer of tangible personal property. 3/29/96.

120.0108.180 **Evidence Artwork was Transferred by Modem.** The transfer of artwork by remote telecommunications, such as modems, is not a sale of tangible personal property. Thus, tax does not apply to charges for artwork that is transferred by modem. The advertising agency must retain some form of evidence to support the claim of transmittal by modem. Such evidence could include the acknowledgment of receipt indicating the recipient's receipt of the artwork by modem. It is also suggested that the seller, advertising agency, state on

the invoice that delivery was by modem and retain a hard copy of the artwork with a dated notation of the electronic delivery. 1/28/97.

120.0108.225 **Extracting Information from Customer's Documents.** A taxpayer contracts to extract information from documents provided by its customer and to perform data entry. Then, the taxpayer returns this information back to the customer in electronic form via electronic transmission to the customer's computer.

Data entry is regarded as taxable fabrication under Regulation 1502(d)(2) if such data entry is transferred to the customer in tangible form such as on storage media or if the taxpayer performs the data entry on the customer's computer. However, if the information is transferred by remote telecommunication and the customer does not obtain any tangible personal property such as tapes, disks, or other storage media, the transfer does not constitute a sale of tangible personal property. (Regulation 1502(f)(1)(D).) 8/31/95.

120.0108.350 **Free Program Updates.** A taxpayer purchases a prewritten computer program. Royalties are paid to the vendor depending upon the amount of use of the program. The program is updated periodically at no additional cost. The updates are made over telephone lines. The providing of updates by telephone lines is regarded as a service related to the sale of the original program. Tax applies to the entire royalty charge. 6/5/81.

120.0108.390 **Furnishing Database Information.** A taxpayer compiles its own, nonexhaustive database containing information on the shipment of prescription drugs. Taxpayer's clients request specialized reports regarding the sale of a particular pharmaceutical in relationship to a particular category of pharmaceuticals. The taxpayer compiles these reports by developing information through statistical analysis of the information in its database. That is, the taxpayer does not merely provide its clients with portions of its database to fulfill their requests, but rather creates customized information through a significant and substantial analysis and selection process.

Under these facts, the taxpayer is regarded as providing tangible personal property incidental to the providing of a service when it provides a single computer tape to its customer in response to a specific inquiry by that customer. Tax would apply, however, to additional copies provided to a customer, or in any situation where the taxpayer provides a significantly similar copy of information to a customer that was previously provided to another customer. 9/16/97. (M98–3).

120.0108.400 **Furnishing of Data to Customers and Processing Customer Data.** A firm supplies a weekly listing of economic indicators and a graphic representation of these indicators to its customers. The firm also receives data from its customers which it uses to generate graphs by computer. In some cases, arithmetic calculations such as averages and trends are made. The sale of the weekly listings of economic indicators is taxable unless the reports qualify for exemption as periodicals. The conversion of customer-furnished data to graphic form is taxable unless arithmetic calculations are made. 9/28/79.

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120.0108.500 **Graphics on Computers.** A graphic artist, an independent contractor, contracts with clients to create and transfer artwork in the following ways:

(1) The graphic artist uses the client's computer to create artwork which is saved on the client's hard disk.

(2) The graphic artist creates the artwork on its own computer and saves the data on a floppy disk. This diskette is then taken to the client's place of business, inserted into the client's computer, and saved on the hard disk. Some additional work may or may not be accomplished.

(a) The diskette is retained by the graphic artist.

(b) The graphic artist leaves the diskette, with the client for backup purposes.

(3) The graphic artist creates the artwork on its own computer and saves the data on a hard disk. This hard disk is then taken to the clients' location and connected to their computer by means of a cable. The data is then transferred to the clients' hard drive.

With the exception of situation (2)(b), sales tax does not apply to the graphic artist's charges in the other situations. In situation (2)(b), the graphic artist's transferring a diskette to the client results in the graphic artist making a retail sale of tangible personal property.

When a person performs labor which is merely the operation of clients' computer system, the labor is not fabrication labor whether the clients' computer is new or used. Saving work to the permanent internal storage (hard drive) of the computer is not fabrication of the computer.

On the other hand, tax applies to charges for artwork when the artist saves the work to a medium which is typically separate from the permanent internal storage of the computer. For example, if the artist were to create the artwork and save it to a disk or print a hard copy, the transfer to the customer of that medium would be a sale of tangible personal property. The artist's transfer of artwork on a new ''customer furnished'' diskette would be a taxable sale. (Regulation 1502(c)(2) and (c)(4).) 03/05/96.

120.0109 **Hourly Charge for Creating Illustrations.** An independent contractor bills his time by the hour, creates designs and illustrations through a computer program, and then prepares a computer presentation file. The client has the option of showing the file on a computer, converting it into 35mm slides, or printing it on paper. Even though the contractor charges by the hour, the charge for creating designs and illustrations is subject to sales tax. Accordingly the charge for the computer presentation file is subject to tax. 10/14/93.

120.0110 **Improvements to Leased Programs.** Taxpayer leased a canned program to its customer. For a set monthly fee, taxpayer also notified the customer of any recently developed improvements to the program. If the customer desired to incorporate the improvements into the program, upon payment of an additional charge, taxpayer recorded the entire improved program on magnetic tape supplied by the customer and transferred the tape to the customer.

AUTOMATIC DATA PROCESSING, ETC. (Contd.)

The recording of the improved program is a taxable fabrication under Regulation 1502(c)(2). The monthly fee to receive notice of the improvements is included in the measure of tax, since payment of the fee is a prerequisite to purchasing the improvements. 11/5/79.

120.0114 **Installation of Computer System.** A company contracts with a customer for the installation of a computer system and an information management system. Specific tasks are:

(1) Installation of some hardware and printers.

Tax does not apply for installing the hardware.

(2) Convert the customer's existing files to the new format.

The charge for converting the existing files to the new format is subject to tax.

(3) Install and test the leased software on the customer's computer and install the customer's converted data files onto the customer's computer.

The charge for these installation functions is not subject to tax.

(4) Train the customer's staff on using the leased software, etc.

Generally, if the charge for training service is optional, the charge is not subject to tax.

(5) Fee covering the cost of the company's staff to travel to the customer's site to perform some of the above functions.

Depending on the taxability of the underlying charge, the charge for travel is taxable or nontaxable. The charge for travel related to nontaxable installation of hardware is nontaxable. The charge for travel related to the reformatting of data is taxable. 8/6/92.

120.0115 **Installation of Software.** Charges attributable to the actual installation and testing of software to ensure that the program operates as required are not taxable. Charges attributable to converting the customer's data to a different format are taxable. 2/14/95.

120.0115.300 **Internet Access.** A company provides Internet access without providing any tangible personal property to its customers. It is not selling or leasing tangible personal property by providing Internet access, and its charges for that access are not subject to tax. 2/23/98. (M99–2).

120.0115.325 **Internet—Access to Database.** A firm collects résumés at job fairs and a variety of other sources. It creates a database of these résumés and sells access to its customers in order for them to conduct searches for potential employees. The firm charges an access fee for the database search and a subscription fee based on the quantity of résumés viewed. The firm does not sell or lease any tangible personal property to its customers in the course of providing this service. Customers use their own computers and the Internet to access the database which is maintained on computers solely within the possession and control of the firm. The firm does not provide any software to the customer.

AUTOMATIC DATA PROCESSING, ETC. (Contd.)

Under these facts, tax does not apply to the firm's subscription charge or access fee to its customers for viewing its résumés database since it is not selling or leasing any tangible personal property. 4/19/96.

120.0115.700 **Lease of Database.** A database system includes application software which has been licensed to the provider of the database. The database provider delivers a diskette to its customer. It cannot sell the system because it does not own the system. The subscriber manipulates the data to obtain information which he desires. The subscriber receives weekly updates of the data base.

The provider of the database is the retailer of the database system if the subscriber is not required to return the diskette. If the subscriber is required to return the diskette, the transaction is a lease. Since the property is not leased in substantially the same form as acquired, the lease receipts are subject to tax. 6/7/91.

120.0115.800 **Library Catalog Information Transmitted via the Internet.** A library contracts for the purchase of books and the transmission of cataloging records via the Internet with each charge stated separately. The sale of the books to the library is taxable as a sale of tangible personal property. However, the charges for the cataloging of records transmitted solely through the Internet is not taxable so long as no tangible personal property, such as a courtesy ''hard copy,'' is received as part of the transaction. 11/24/97. (M99–2).

120.0115.900 **License for Copying Customized Basic Operating System Programs.** The taxability of license fees and royalty payments for reproduction or copying customized basic operating system programs is set out in Regulation 1502(f)(1)(B). Tax does not apply to the license fees and royalty payments if the customers are not the end users of the operating system programs, but reproduce these programs for sale or license to their customers. If the customers were the end users, tax would apply to these charges for the use of the program. 1/14/88.

120.0116 **License and Royalty Fees.** If a transaction involves the transfer of software but the purpose of the transfer is to grant the transferee the right to copy and sell software under circumstances that such copying and selling would otherwise be a violation of the transferor's federally protected copyright interests, the transfer is not subject to tax. Tax does not apply whether the transferee sells the program in the form in which it is received, modifies it and sells the modified program, or incorporates it into another program and sells that program. 11/17/94.

120.0117 **License/Sublicense of Canned Software.** A customer of a software retailer has requested the retailer to obtain a license for canned software and, in turn, sublicense the software to it in substantially the same form as acquired by the retailer. The distributor of the software is aware of the sublicensing by the retailer. This license and sublicense is a nonexclusive, nonassignable, and nontransferable license to use the program. The program can only be used on one computer where the program is installed.

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The license term is characterized as a lease for an initial period of 12 months. The licensee (and sublicensee) have the right to extend the term for two additional 12-month periods unless either the licensee or distributor gives notice to the other party of the intent to terminate or renegotiate the agreement at least 60 days prior to the anniversary date. If within this 3 year period, the license is terminated for any reason, the licensee is to de-install the program from the computer on which it is installed and either certify to the lessor that the program was destroyed or return the program to the distributor.

The license fee is $27,000 and is due upon installation of the program. The annual renewal fee (referred to as a maintenance fee) is $6,000 and is due for each of the 2 years commencing on the first anniversary date. If after the three year period mentioned above, the licensee fails to continue its ''lease'' payments (maintenance fees), the program upgrade and support is terminated and the distributor has no obligation to reinstate. Licensee is not required to return or destroy the program after this three year period.

The retailer pays its vendor $27,000 upon installation and $6,000 on anniversary date and the lessor charges its customer $32,000 upon installation and $7,000 on the anniversary date.

In this case, there is an outright sale to the retailer followed by an outright sale by the retailer to its customer. During the initial three year period, if the license is not renewed, the retailer has the option of either certifying that the program was destroyed or of returning it to the distributor. After three years, the retailer apparently keeps the program even if the license is terminated. The retailer thus obtains possession of the program with no requirement to return it. This is a sale not a lease. (Regulation 1502(f)(1)(A) & (B).) The retailer's customer obtains the software on the same basis. Thus, the retailer is making an outright sale to its customer. The sale to the retailer is a sale for resale and is excluded from sales tax. The retailer's sale to its customer is the taxable retail sale. The measure of tax from that sale is the $32,000 sales price. Also, the $7,000 is subject to sales tax since ''maintenance'' contracts providing for supplying updates and later releases of the software are considered sales of tangible personal property. (Regulation 1502(f)(1)(C) and annotation 120.0550.) 6/22/95.

120.0118 **Microfiche and Digital Scanning.** Microfiche filming and digital scanning of customer furnished documents which results in the transfer of film, tape, disks, etc., is taxable. These activities are merely the conversion of customer-furnished data from one physical form to another. 8/12/94.

120.0120 **Microfilm.** Charges for placing exposed, developed microfilm on keypunched, aperture IBM cards, both the film and the cards having been supplied by the consumer, are taxable receipts from sales. The labor involves the creation for the first time of the desired article, i.e., the card with the film mounted thereon, and is not repair or reconditioning labor. 10/9/62.

120.0125 **Modification of Customer's Electronic File.** The company's customer decided that electronic files, that had originally been created by the company, required certain changes (additions and deletions). The labor of

modifying the data was manually completed using keystrokes and the files were returned to the customer on the same medium. The customer was billed an additional charge for the modification. The charge is subject to tax.

Charges for modifying or treating consumer-furnished tangible personal property (cards, tapes, discs, etc.) are generally subject to tax. 3/23/92.

120.0135 **Multiple Location Access to Data Base.** A taxpayer provides a database of drug information to its customers. The customers have multiple locations throughout the country. The taxpayer extracts from its comprehensive database a limited database tailored to the requirements of the individual customer. Each month, each customer receives an update for its database. The update is transmitted electronically and only to the customer's headquarters location. The customer then electronically transmits the update to each of its other locations. The customer is charged a set fee per location. Tax does not apply as long as all information is transmitted by the taxpayer electronically and no tangible personal property is transferred.

If the database information was sent in tangible form to this state, tax would apply. 6/29/94.

120.0275 **Off-Line Printouts.** A taxpayer maintains a number of data bases which are available for access by customers. Customers can obtain information electronically and can print the information on their own printers. The taxpayer's charges to customers are based in part on network time. To save network time charges, a customer may instruct the taxpayer's terminal to print information on the taxpayer's printer. The taxpayer then sends the printout to the customer. The taxpayer makes a single charge based on unit price which includes computer time and royalties. Tax applies to the total charge for material printed on the taxpayer's printer. 9/27/79.

120.0290 **On-Line Entertainment Service.** A taxpayer operates an on-line interactive entertainment service which enables subscribers at different geographic locations to use personal computers to communicate with each other. Each subscriber uses a personal computer, a modem and taxpayer supplies software to operate the service. Subscribers pay a subscription fee. Upon payment of a shipping and handling charge, new subscribers receive on floppy disks a software which enables them to access the taxpayer's entertainment services. There is no separate charge for the software. The software is upgraded periodically and subscribers are sent software enhancements on disks at no extra charge.

Tax does not apply to the subscription charge. If the ''handling'' portion of the ''shipping and handling'' fee represents 50 percent or more of the taxpayer's purchase price of the software, the transaction is a retail sale of the software subject to sales tax (Regulation 1670). If it is less than 50 percent, the taxpayer is regarded as the consumer of the software. (Regulation 1670.) 7/11/94.

120.0309 **On-Line Service.** University libraries subscribe to several on-line services which provide information used by students and faculty to support

instructional programs and research. Information obtained from these types of services may be viewed on screen by library patrons, downloaded to floppy disks, or printed out locally at the discretion of the patron.

Since the information sought by the patron is transferred by remote telecommunication from the seller's place of business to the Universities, no tangible personal property is transferred. Therefore, sales or use tax does not apply to charges for such services. 10/23/95.

120.0310 **On-Line Service and Sale of CD-ROMs.** A company is contemplating the transfer of CD-ROMs to its customers in connection with an on-line electronic data service provided over the Internet. Under plan 1, the company will charge the customer for both the CD and the monthly connection over the Internet. Under plan 2, the company will give away the CDs free of charge and only charge for the monthly connection on the Internet.

Under plan 1, the transfer of the CD-ROM constitutes a sale of tangible personal property. Therefore, the amount of the total charge attributable to the sale of the CD-ROM is subject to sales tax.

Under plan 2, the transfer does not constitute a sale of tangible personal property assuming there is no obligation on the part of the customer to purchase any tangible personal property or any service from the company. Under these circumstances, the transfer of the CD-ROM is not subject to sales tax. However, the company is the consumer of the CD-ROM and the sale of the CD-ROM to the company is the taxable retail transaction. 1/17/96.

120.0350 **Optional Maintenance Contract—Equipment and Software.** A taxpayer is a manufacturer of industrial equipment used in the production of tangible personal property. One of the component parts of the equipment is a computer which provides necessary automation for the equipment. The computer is integrated into the overall system and is not used for any other purpose. The software controls the computer which in turn controls the equipment. The software was developed specifically for use with the system (equipment) and is not useful on any other equipment. The computer and related software are not major components of the equipment and account for less than 10% of the equipment's cost.

After the expiration of the standard equipment warranty provided to customers at the time of purchase, customers have the option to enter into a lump-sum service agreement with the taxpayer. Under the agreement, the taxpayer is required to perform various preventative and remedial maintenance procedures on the equipment. Required materials are provided on a no-charge basis. In addition, the taxpayer will furnish and install software updates as they are released by the taxpayer for equipment covered by a service agreement at no additional charge to the customer.

The taxpayer has been accruing use tax on the cost of materials furnished under the optional service agreements. At issue is the application of tax to the portions of the service agreement attributable to the software.

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Regulation 1502(f)(1)(C) provides that an optional maintenance agreement that contemplates the providing of program updates on storage media is regarded as a contract for the sale of tangible personal property. Tax applies to the sale or use of such maintenance agreements inside this state. Under these facts, the service agreement is regarded as both an optional maintenance agreement of the equipment as well as an optional maintenance agreement for the software. As such, tax applies to that portions of the lump-sum service agreement that represents the charge for the optional software maintenance. The taxpayer should report and pay tax to the Board measured by the amount allocated to the software maintenance portion of the lump-sum charge for the service agreement. 5/29/96.

120.0365 **Optional Software Maintenance Contract.** Tax applies to charges for optional software maintenance contracts if it is contemplated that during the terms of the contracts customers will receive revised or updated versions of the prewritten programs if there is a problem identified with the programs. The transfers of updates or revisions are not incidental to the provision of support services, even if the revisions or updates are rare. 3/23/88. (Am. 2003–2).

(Note: Regulation 1502 was amended effective December 10, 2002, so that operative January 1, 2003, 50 percent of the charge for optional maintenance agreements is subject to tax. Prior to that date, 100 percent of the charge for optional maintenance agreements was subject to tax.)

120.0372 **Out-of-State Use of Programs.** A taxpayer has computer centers in California and in other states. It purchases prewritten programs. Royalties are paid to the vendors depending upon the total use made of the programs. In some cases, the purchased programs are copied and the copies are sent to the out-of-state centers. In other cases, the original tape is sent to the out-of-state centers by the taxpayer. Tax applies to the entire royalty charge because there was a completed taxable sale in California. It is immaterial that there is a use outside the state. 6/5/81.

120.0387 **Pen Plotted Drawings.** Pen plotted drawings are furnished based on drawings, blueprints, sketches, and written description furnished by customers. This transaction constitutes the mere reformatting of data or converting data from one form to another, and is taxable under the rationale set out in *Albers* v. *State Board of Equalization,* 237 Cal.App.2d 494. 12/20/88.

120.0400 **Photographic Image.** The transfer of a photograph through a remote electronic wire service is not a transfer of tangible personal property. Charges for such service is nontaxable.

''Remote'' means that the transmission must occur from premises other than that of the receiver. 11/26/91.

120.0406 **Processing Healthcare Claim Forms.** A taxpayer, who is located out of state, is engaged in the business of processing healthcare claim forms for California customers. The taxpayer receives either an electronic or physical claim from its customers and converts or reformats the claim to the proper format for the ultimate payer of the claim. The taxpayer then transmits the converted or

reformatted claim to the appropriate insurance company (payer) for processing and provides its customer with a copy of the claims it processed in a CD ROM format. The taxpayer charges its customers a ''claims conversion fee'' which includes ''data analysis and reporting'' and an ''archival fee'' for providing of a copy of the claim on CD ROM. The data analysis and reporting consist of summarizing or extracting information from customer-furnished claims forms for inclusion in a report wholly separate and apart from the CD ROM provided as part of the taxpayer's archival fee.

When the taxpayer electronically transmits claims to the payer, the customer is charged a ''one-way transmittal fee.'' Also, a ''clearinghouse fee'' is charged to the customer for electronically transmitting claims from the customer to the taxpayer, repricing the claim and transmitting the claim to the payer. This fee includes data analysis and reporting. Under these facts, tax does not apply to taxpayer's charges for claims conversion since that fee represents a charge for the processing of customer-furnished information. The ''clearinghouse fee'' is similar to the ''claims conversion fee'' in that the taxpayer summarizes or extracts information from customer-furnished claims for inclusion in a report wholly separate and apart from the CD ROM provided as part of the taxpayer's archival fee. As such, tax also does not apply to the clearinghouse fee. Also, tax does not apply to ''one-way transmittal fee'' since this fee only relates to the electronic transmission of a claim from the taxpayer to the payer.

Tax does apply, however, to the taxpayer's ''archival fee'' since it is only converting a claim from an electronic image to a CD ROM and then selling that CD ROM to its customers. Sales tax applies to this fee when the sale of the CD ROM takes place inside this state and there is some participation in the transaction by a location of taxpayer in California. When sales tax does not apply, use tax is imposed on the sales price of the CD ROM; the taxpayer must collect that amount from its customers and pay it to the Board. 06/24/96.

120.0410 **Program Error Corrections.** A taxpayer designs and sells software programs. It also sells a lump-sum optional maintenance contract which offers customers telephone support, plus software updates and enhancements. The taxpayer discovers errors in a software program and issues error corrections on diskettes to all of its software purchasers including those who had not purchased a maintenance contract. On the basis that all software purchasers receive corrections, the taxpayer contends that the maintenance contracts are entirely for services not subject to tax.

Even though the taxpayer gratuitously provides error corrections to its customers who do not purchase maintenance contracts, the taxpayer's maintenance contracts are not ''solely consultation services.'' The taxpayer charges the maintenance contract customers a lump-sum amount for a maintenance contract which offers all updates, enhancements, and technical support. Also, the taxpayer transfers all program error corrections to all software purchasers by diskettes. When there is a taxable transfer of tangible personal property, the tax applies to the gross receipts including all services which are part of the sale, with only those deductions allowed by statute. Accordingly, the lump

sum amount charge for the maintenance contracts is fully taxable, even though a portion of the charge is for consultation services. This is because the consultation services are a mandatory part of the maintenance contract under which the taxpayer sells tangible personal property since the customers do not have the opportunity to purchase the consulting services separately from the purchases of the updates or enhancements. 4/19/94.

120.0455 **Reprogramming Activity Conducted on Customer's Computer.** In reprogramming, updating, or error correcting, a taxpayer's employees take a floppy disk to the place of business of the customer, insert the disk in a disk drive, and copy the program into the memory of the customer's computer by operating the computer. The taxpayer's employees then remove the disk and return with the disk to the taxpayer's place of business.

The charges for reprogramming activity conducted in this manner are not subject to the sales tax. There is no title transfer transaction and there is no lease transaction. Also, the reprogramming of a programmable piece of equipment does not constitute fabrication or processing of the equipment. Rather, the charges made for reprogramming are charges for the performance of a service, not for sale of tangible personal property. 3/23/95.

120.0490 **Sale of Object Code and Source Code.** A firm transfers source code to original equipment manufacturers (OEM) together with the object code. The OEM has a limited license to incorporate the object code into bundled product which it sells. The OEM may not sell or license the object code as a stand alone. The OEM uses the source code to create and modify the object code in various versions of hardware and software environments and to provide support services for bundled products.

Generally, the charge for the object code is based on per unit or percentage of the sales price of the bundled product. The charge for the source code may be incorporated into the license fee of the object code or it may be a separate flat fee site license.

The transfer of the source code is incidental to the transfer of the object code and is necessary for the OEM to manufacture and distribute the bundled product. The charge for the source code is nontaxable. The fact that the charge may be separately stated does not affect this conclusion. 5/6/93.

120.0510 **Sales of Computer Software and Hardware.** In making sales of computer software and hardware systems, a company itemized its billings, separately listing charges for hardware, software, and sales tax reimbursement on the hardware charges only. The software was fabricated out of state and shipped to the purchaser directly from the out-of-state developer. The transactions consisted of the company: (1) soliciting the sale of the system, (2) billing the customer for the hardware, software, training, and sales tax reimbursement on the hardware; (3) receiving payment from the customer in full; (4) paying the developer for the software, and (5) receiving a commission on the software sale from the developer. The company claims it always acted as agent for the software

developer and that the collection of payments from the customers does not affect its status as an agent for the out-of-state developer.

The fact that the company collected payments for the software does not conclusively show that the company was selling the software on its own behalf, rather than as an agent of the developer. However, it does create an inference that the company was the seller of the software. Therefore, it is necessary for the company to rebut this inference. 11/6/92.

120.0514 **Sale of Software and Maintenance Contracts.** An out-of-state taxpayer provides data processing and consulting services to bank, mortgage companies and credit unions in the origination, secondary marketing and servicing of single family mortgage loans. The taxpayer also sells software (prewritten) licenses to clients who prefer to do their own processing. The client has the choice of receiving the programs on tapes or to have them transferred by remote telecommunication. In conjunction with the sale of software the clients have the option of receiving updates of the software and telephone support under a support agreement. The clients are sent a tape with the changes each month. The tape contains a program activity report that lists the modules that are being changed that particular month. The client also receives a memorandum (on paper) which highlights some of the changes for the month. For most of the clients these fees are combined (referred to as bundled billing) into one amount and billed monthly. Some of the old contracts allow the separate billing of enhancements and telephone support. The enhancement/telephone support billing is a totally separate fee from the license fee. The taxpayer is looking into transferring these monthly updates and memorandums by remote telecommunications to its clients.

The sale of prewritten computer programs furnished on storage media constitutes a sale of tangible personal property that is subject to sales or use tax. The measure of tax includes all amounts charged by the seller for the sale of the software, including all licenses and other end user fees. (Regulation 1502(f)(1)(B).)

The sale of a software maintenance contract (updates and error correction provided on storage media, such as tapes) is also a sale of tangible personal property, and it is therefore subject to sales or use tax. (Regulation 1502(f)(1)(C).) The charges for services such as telephone support are taxable as part of the sale of that maintenance agreement unless such services are optional and the customer may contract for those services for a separately stated price. (Regulation 1502(f)(1)(C).) The services are optional only if the customer may purchase the maintenance contract without purchasing the service.

Tax does not apply where the only transfers to the customer are by remote telecommunication from the seller's computer to the customer's computer and the customer does not obtain possession of any tangible personal property in the transaction. If the transfer of a prewritten program is a nontaxable transaction, then the seller is the consumer of tangible personal property used to produce written documentation or manuals that are transferred to the customer for no additional charge. If a separate charge is made for the documentation or manuals, then tax applies to the separate charge. 11/3/95.

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120.0518 **Sale—Transfer via Modem.** The transfer of illustrations to a client via modem for a fee licensing their use is neither a sale nor a lease as there has been no transfer of tangible personal property. The fact that the illustrations could have been transferred on disc or on paper during the illustrator's routine visits to the client is irrelevant as neither alternative was taken. 3/11/94.

120.0520 **Sales of Programs to Value Added Reseller.** A computer software company transfers its programs to a Value Added Reseller (VAR). The VAR generally uses the company's programs to develop, market, and sublicense application programs which include, as a component part, the company's programs or a function of the company's program. Since the VAR does not sell the actual software received from the company nor does it physically incorporate the software into tangible personal property sold by the VAR, the transfer by the company is not a sale for resale. However, a license fee paid specifically for the right to reproduce or copy a program to which a federal copyright attaches is not taxable. (See regulation 1502(f)(1)(B)). 7/20/93.

120.0522 **Scanning.** Since original information is not developed in the scanning process, scanning is regarded as the conversion of customer furnished data from one physical form of recordation to another. Charges for scanning are therefore subject to tax when the scanning results in the transfer of disk or other storage media. When the scanning is transmitted electronically and there is no transfer of tangible personal property, tax does not apply. 2/18/94. (Am. 99–2).

120.0524 **Security Key Installed with Load and Leave Software.** A taxpayer sells and physically installs software on the customer's computer at the customer's office, without leaving any software disks with the customer. The taxpayer also installs a ''dongle'' on the customer's computer. This is a piece of tangible personal property used as security key for the software. The software was designed to be effectively nonfunctional without the installation of the dongle. Therefore, when the customer purchases the software, the customer must also obtain an important piece of tangible personal property that the customer will use to make the software functional. Accordingly, the charge for the software license that involves the transfer of the dongle is taxable without regard to the manner of transfer of the software. 9/23/99. (2000–2).

120.0525 **Settlement of Disputed License Fees.** A customer acquired software products under a license which limited its use to a central processing unit. The vendor claims that the software was being used in an unauthorized manner. The customer disputed the claim, but ultimately paid $250,000 in settlement of the claim. The $250,000 is part of gross receipts subject to tax. The settlement fee was paid in order to settle the dispute over amounts owed attributable to the acquisition of the software and the accompanying license fees. Such payment for additional license fees are subject to tax. 3/17/97.

120.0528 **"Site License" Fees.** ''Site license'' fees, which permit purchasers of computer software to make additional copies, represent additional gross receipts from the original sale of the pre-written computer program. If a customer first

purchases the program, and later purchases the site license, tax applies first to the program and at a later date to the site license fees. 1/27/86.

120.0531 **Software and Software Updates Installed into Customer's Computer.** When a person operates a customer's computer to transfer computer software directly into the permanent storage memory of the customer's computer, and maintains complete and exclusive control over the customer's computer during the entire process, the transaction is not a sale of tangible personal property, provided the taxpayer does not provide the customer with a hard copy or any other tangible personal property. On the other hand, when the transferor downloads the software onto ''some other type of computer storage device owned by the customer,'' such as diskette, tape or CD, the transferor would be performing fabrication labor on customer-furnished property. This fabrication is a ''sale'' under Section 6006(b). The same analysis applies to optional software maintenance agreements where software updates are delivered as described above. 4/10/97.

120.0532 **Software Installation Charge.** A retailer transfers software to customers on tangible media pursuant to a basic software license agreement. The software is for the customer's own use. The license fee includes all charges for installation of this software, installation support services (includes training classes for customer's employees), and warranty. Out-of-pocket expense costs and expenses incurred by the retailer when providing pre-installation support services and installation support services or warranty work are separately billed to purchaser and include transportation expenses, motel accommodations, meals, telephone charges, and mailing expenses.

A charge for testing a prewritten program on the purchaser's computer to ensure that the program operates as required is the only charge regarded as an installation charge. (Regulation 1502(f)(1)(E).) Although there is no requirement to separately state such charges, the Board strongly recommends that it be separately stated. All the other services listed which the customer is required to purchase in order to purchase the software are services part of the sale, the charge for which is subject to tax regardless of whether they are separately stated. The separate charges for out-of-pocket expenses are subject to tax except for those related to nontaxable installation. The charges should be prorated based on the charges to respective services to which they relate. 4/26/91.

120.0535 **Software Libraries.** A taxpayer is in the business of developing, licensing, and manufacturing hardware and software products and technology for distributed communications and control which allow systems to operate on an interactive basis. The taxpayer has a set of software libraries for the programming language. Portions of the libraries are used by customers who create application programs to incorporate into their programs. The libraries are delivered on a set of disks which contain an inexecutable object code and do not function as an application program by themselves.

A software developer enters into a written license agreement with the company governing the developer's rights relative to the libraries and has no right to resell

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the libraries as received. A developer only has the right to resell an application program which has incorporated portions of the libraries.

The transfer of the libraries are nontaxable when the licensee acquires the software for incorporation into applications which are published and distributed for a charge. Any storage media used to transmit the programs to the licensee are incidental to the nontaxable transfer.

When the company licenses a library to a licensee to create an application program for the licensee's own functional use, the charge is subject to tax.

A statement incorporated into or attached to the signed license between the company and the developer indicating that the library is being licensed for publication and distribution or whether it is being licensed for use would be evidence of the type or purpose of the transfer. However, if the licensee were to make a use of the program which renders the original transfer by the company subject to tax, the company would be liable for the payment of such tax. 9/11/92.

120.0538 **Software License—Right to Use and Copy.** "A" is the licensee of certain computer programs (Software Products) which it obtains from "B," an out-of-state author/licenser. The Software Products are copyrighted by B and various rights under the copyrights are transferred to A for which royalty payments are made. Copies of the Software Products are distributed for consideration in modified or unmodified form by A to third parties. A reports and remits to the Board sales tax computed on the gross receipts received for the copies of the Software Products.

The software agreement between A and B specifically grants A end user rights. Therefore, a portion of the fees paid by A are, in fact, attributable to end user fees. The supplements to the software agreement list designated CPUs and identify charges as "right-to-use fees" and "sub-licensing fees." The software agreement also states in part "solely for (A's) own internal business purposes." Thus, all amounts paid by A for the software agreement are subject to tax because the rights acquired are to use the software program and not to sell copies.

Parts of the sub-licensing agreement appear to come within the nontaxable area. The amounts paid for the right to make copies of the program for sale and for the right for demonstrating the sub-licensed program are not taxable. On the other hand, the amounts paid under the sub-licensing agreement for testing of CPU's and all other amounts paid for A's own use and are subject to sales or use tax. 3/16/88.

120.0539 **Software—License to Use and Sell.** Corporation A is a software manufacturer that purchased certain property from Corporation B which is also in the software developing and manufacturing business. The property purchased consisted of source code, duplication copies, consumer copies, and software documentation. The source code is maintained on a unique computer in another state, but the working copies are located in California.

The contract provided for Corporation B to retain royalties, which are contingent on future sales volumes by Corporation A, up to a stated amount. The source code is protected under federal copyrights. Corporation A purchased the

source code to modify or expand it for purposes of copying and selling the modified program to others. Since the source code is protected under federal copyright, tax does not apply to Corporation B's sales of the source master code or to the transfer of tangible copy of the program transferred concurrently with the granting of the right to copy the software for the purpose of selling it, and not for other use. Tax does not apply to the concurrent transfer of the tangible copy of the program because the transfer of that copy is considered to be incidental to the granting of the right to copy and sell the program.

In addition, Corporation B has transferred copies on storage media in addition to the single copy necessary to transmit the program for purposes of copying and selling. These copies are to be used for research and advanced development. Thus, Corporation A has also sold tangible personal property for use as a manufacturing aid. The sale of such additional tangible personal property is not incidental to the transfer of the source code. Corporation A also transferred software documentation, manuals, and other tangible personal property. Sales tax applies to the sale of that property if located inside California at the time of sale, and use tax applies to the use of property purchased by Corporation A outside California which is first functionally used inside this state, or which is brought into California within 90 days after purchase unless the property is stored outside this state on half or more of the time during the six-month period immediately following its entry into this state. 4/29/96.

120.0540 **Software License Transfer Fee.** A customer has been using software, purchased from the taxpayer, for several years. This customer paid sales tax reimbursement on the original software license when first purchased. The software is licensed to be used on only one computer system. The customer recently upgraded its computer hardware to new equipment. The taxpayer charged the customer a software license transfer fee to allow it to move the software to the new equipment.

The software license transfer fee charged to the customer to permit that customer to utilize the software on new computer equipment relates to the original sale of the software. Since the original sale was taxable, the additional fee is also taxable. 7/18/95.

120.0543 **Software Maintenance Agreements—Delivered Electronically.** A taxpayer, a software developer and publisher, sells software licenses and software maintenance agreements to its customer. Maintenance agreements are optional and are typically sold for a term of 12 months and renewed annually unless terminated by either party. Currently, the software licenses and updates provided in the software maintenance agreements are delivered in tangible form. The taxpayer will have the capacity to deliver software and updates electronically in the near future. As a result, future software licenses and maintenance agreements may not include a transfer of tangible personal property. Some customers have requested to terminate their existing maintenance agreements at the end of their 12-month term and sign new agreements detailing that the updates be transmitted electronically. The new maintenance agreements will be regarded as the transfer of nontangible personal property where the taxpayer and its customers actually

terminate their previous agreements and enter into new (and valid) agreements requiring the transmission of updates in electronic transmission, and the taxpayer actually transfers the updates in electronic transmission to its customers.

On occasion, customers will purchase additional software licenses throughout the year. In order to have all of the software maintenance agreements expire at the same time, the taxpayer's practice has been to terminate the existing maintenance agreement (granting credit for the unused portion) and then to have the customer sign new 12-month maintenance agreements for both the pre-existing and newly purchased license. All would then have the same term. The new agreements require electronic software transmission. The sale of the initial maintenance agreement was a taxable sale. A customer's return of only a portion of a maintenance agreement does not qualify as ''returned merchandise'' pursuant to Regulation 1655(a). There is no provision which allows the taxpayer to claim a tax credit (or deduction) based on the customer's return of an unused portion of the maintenance agreement.

In connection with its sales of software electronically, the taxpayer may send documentation in tangible form to its customers. This documentation may be sent either on paper or a CD ROM. The CD ROM does not contain any software such as a search engine in which to access particular information on the disk. Under these facts, the taxpayer's transfer of software documentation (and not the software itself) to its customers in either CD ROM or paper form is subject to tax where it makes a separate charge to its customers for such documentation. Where no charge is made, the taxpayer is the consumer of its documentation materials. 4/19/96.

120.0544 **Software Maintenance Agreement—Updates Electronically Delivered.** Taxpayer licenses software and software maintenance agreements to its customers. Maintenance agreements are optional and are usually sold in 12-month terms which renew annually unless terminated by either party. Currently, the software updates provided in the maintenance agreements are delivered in tangible form. New customers or renewals may request updates be delivered electronically.

The current agreement provides software updates be provided in tangible form and, thus, are subject to tax. If new customers or renewals contract for updates to be delivered in tangible form, tax applies to charges for the entire 12 months of those contracts. However, if new customers or renewals request the transmission of software updates solely by remote telecommunication, those new or renewal maintenance agreements will not be subject to tax provided the taxpayer delivers its software updates solely by remote telecommunications (e.g., via e-mail or internet transmission), and its customers do not receive any tangible personal property (such as storage media) as part of its update transaction. 5/29/97.

120.0550 **Software Maintenance Contracts.** Under a licensing agreement, a business provides software and maintenance of that software to a client. The maintenance is for providing updates and future releases of the software. The contract for providing updates and future releases is a contract for the sale of

tangible personal property. The charges for such a software maintenance contract are subject to sales tax regardless that the maintenance contract may be optional with the purchaser.

The issue of optional v. mandatory charges on software maintenance contracts arises as to charges for telephone or on-site consultation services. If the purchaser may, at its option, contract for consultation services for a separately stated price, these optional charges are nontaxable. If the purchaser does not have the option to purchase the consultation services in addition to the storage media, the charges are taxable as services which are part of the sale of the storage media. 5/6/93.

120.0551 **Software Licensing.** A company develops and publishes video games that are currently manufactured and distributed on floppy disks. The company may issue nonexclusive licensing agreements for their product to persons who could be granted the right to convert and modify the video games to be compatible with computer/interactive entertainment formats. The company would supply to the licensees object code masters for the licensed games and mechanical art or film for all components necessary to complete the licensed products. The licensee pays the company (licensor) royalties equal to a percentage of net sales for the sale and distribution of the licensed products.

Royalties paid for the right to reproduce or copy a program to which a federal copyright attaches are not subject to tax provided the purpose is to publish and distribute the program to third parties for consideration.

Charges for transfers of mechanical art and film in connection with such licensing agreements are subject to tax.

Charges for transferring the data from floppy disc to CD ROM are subject to tax.

Rentals of video games to consumers are subject to tax pursuant to Section 6006(g)(7) and Section 6010(e)(7). 9/2/92.

120.0552 **Software Licensing.** A software products company markets a comprehensive mechanical computer aided engineering software system. The program, which is licensed, is an application program that permits a computer to perform specific tasks. The engineering technology is transferred to the end user on magnetic tape. The end user customer signs one Master License Agreement. Additional software may be ordered by executing a supplemental Licensed Software Designation Agreement. The customer can obtain either an annual license or perpetual (an extended term) license.

When a customer obtains a perpetual license, they will frequently also obtain optional maintenance and support services. These services entitle the end user to receive services including:

(1) updates and extensions on amendments of user documentation (manuals),

(2) new versions of licensed programs which encompass improvements, extensions and other changes, and

(3) corrections to user documentation and/or program codes.

AUTOMATIC DATA PROCESSING, ETC. (Contd.)

The transactions in question are:

(1) The customer obtains a perpetual license for two simultaneous users. Eight months later, the customer executes a new Agreement to expand to four simultaneous users. No additional tapes or manuals will be sent to the customer, but the customer is charged a fee for the addition of the two simultaneous users.

(2) The customer obtains a perpetual license for a drafting module. After three months, the customer adds the solid modeling module which is embodied on the same magnetic media as the drafting module. No additional tapes are sent to the customer. An additional manual is sent and a fee is charged for the additional module.

(3) The customer has obtained an annual license for a module and renews for an additional year. No additional tapes or manuals are sent to the customer, but an annual license fee is charged. The customer claims that additional charges are nontaxable because no additional tangible personal property was transferred.

The regulation provides that charges are nontaxable when the purchaser does not obtain possession of any tangible personal property. Under the facts provided, possession of tangible personal property was transferred and a charge was made for the customer's increased use of the property. The fees in each of the described situations are subject to tax. 1/6/92.

120.0560 **Software Maintenance Policies.** A retailer of laser printers and related prewritten or ''canned'' software also offers a maintenance policy for the software. The maintenance policy has two features, telephone consultation and updates or program enhancements. The updates are transferred on magnetic tape and are also ''canned''. The customers who purchase software are not required to purchase a maintenance policy but those that do must purchase the entire package, the telephone consultation and the updates. The charge is billed lump sum and no allocation is made between the telephone consultation and the updates. The company views the updates and program enhancements as incidental to the telephone consultation service.

Generally, telephone consultation is a service which does not by itself result in a tax liability. However, since the purchasers of the maintenance policies had to purchase the entire package, any person desiring the program updates had to pay for the telephone consultation as well. It follows that the telephone consultation was a ''service that was part of the sale'' of the program updates, and that the entire charge to the customer for the software maintenance policy is subject to tax. 7/16/91.

120.0560.225 **Software Maintenance Services via Modem.** A taxpayer's contract with its customers specifies that taxpayer would perform its software maintenance services, including transmission of program updates, by remote telecommunications means, i.e., by modem. In fact, the taxpayer would not contract with the customer unless the customer had a modem in order to receive software maintenance by telephone. Since the transfer of program updates is by remote telecommunications, there is no transfer of tangible personal property. Therefore, charges for this software maintenance service is not subject to tax. 3/23/95; 4/28/95.

AUTOMATIC DATA PROCESSING, ETC. (Contd.)

120.0560.600 **Software Rental and Installation Agreement.** A taxpayer entered into a contract to license its software programs on a rental basis. It also rented computer hardware (on which it paid California sales tax reimbursement at the time of purchase) as well as a third party software license (on which it also paid sales tax reimbursement at time of purchase). In addition, the taxpayer's monthly charge to the client included a charge for installation and upgrade work.

The sale of the taxpayer's prewritten computer programs transferred to the customer in the form of storage media constitutes a sale of tangible personal property. Tax applies to the entire amount charged for the prewritten programs, including all license fees. (Regulation 1502 (f)(1).)

Labor charges for installation of prewritten programs are excluded from the measure of tax. Installation includes the actual installation of software and the testing of the prewritten programs on the purchaser's computer to ensure that the programs operate as required. (Regulation 1502(f)(1)(E).) This exclusion does not encompass any other services, such as converting a customer's data into a format suitable for use with the new software. Conversion services are part of the sale of the prewritten program and charges attributable to such services are taxable.

Since the taxpayer has timely paid "sales tax" on the hardware and the third party software and they are being leased in the same form as acquired (taxpayer transferred physical possession of the storage media on which the original third party software was acquired), tax does not apply to the amount charged by the taxpayer for the lease of these items. 1/18/96.

120.0560.750 **Software Sublicensing Agreements.** A software licensor (L) provides software to a computer equipment manufacturer (M) to be sublicensed to the end users of M's equipment. The agreement between L and M provides for a number of specified fees, some of which are taxable and some of which are not taxable.

Nontaxable fees include: An initial participation fee and an annual nonrefundable renewal fee, both of which are paid to L by M for the right to participate in the sublicensing program; commissions paid to M by L for each sublicense M issues to an end user; royalties paid by M to L for each sublicense issued; fees for optional product support offered by L through M to M's sublicensees; fees paid by M to L for requested porting of program updates; and certification fees.

Taxable fees include: Charges to end users for the use of pre-existing programs, and technical support service fees which provide for updates paid by the end-user where the end-user has contracted directly with L or with M. 9/26/91.

120.0560.825 **Software Support Agreement.** A taxpayer sells software packages and software support agreements. Customers may choose one of the following support agreement options: full support or after hours support. Full support includes telephone hotline support as well as software upgrades released during the maintenance period. The taxpayer charges one price for this full

support. There is no breakout of price between the hotline and the upgrades. When an upgrade is released, the customers receive a software upgrade tape which they load on their computer system. The taxpayer's employee then dials into the customer's system via modem and performs the procedures to actually install the new upgrade. The other option, after hours support, basically consists of telephone hotline support. The customers who choose this option are not entitled to any software upgrades. A customer initially purchasing a software package is required to purchase one of the maintenance options for the first year. After the first year, the support agreement becomes optional. If a customer elects to discontinue the support, the customer cannot receive any future software upgrades unless all back support charges are paid.

Since the customers are required to purchase one of the maintenance alternatives for the first year, whichever support contract the customer selects is mandatory. Thus, the taxpayer's charges for all first-year support agreements are taxable. Even after the first year, all the taxpayer's charges for full support are taxable, even if that support is truly optional since the customer cannot purchase the software portion without also purchasing the services. The taxpayer may not deduct its charges for the services even if separately stated.

After the first year, when the maintenance contracts are optional, the taxpayer's charges for its after hours support are not taxable if they consist entirely of telephone support. When a customer who had discontinued support pays ''back support charges'' as a condition to obtaining a software upgrade, such charges are part of the sale of the upgrade and are subject to tax. 4/15/96.

120.0561 **Software System—Access by Modem.** A taxpayer is engaged in the business of providing computer services and software to school districts. It entered into a licensing agreement which included the following tasks:

(1) Computer hardware review and planning session.

(2) Software installation, training, users manual documentation delivery.

(3) Final acceptance of software system.

The use of the software system will be made available to the school district through a telephone dial-up to the taxpayer's computer.

This is a nontaxable contract for service only and does not call for the transfer of tangible personal property. The school district's use of the program through a modem and the computer files prepared by the taxpayer also constitute nontaxable services. 7/31/87.

120.0562 **Software Technical Assistance.** Charges for software technical assistance given on a noncontractual, per-call basis are not taxable provided there is no tangible personal property transferred to the customer. 9/24/96.

120.0563 **Source Code Transfers.** A firm encodes its computer program on a master (ROM BIUS) chip, and transfers the chip together with the right to reproduce identical copies of the chip to its customer. For each chip copied the licensee pays a royalty.

AUTOMATIC DATA PROCESSING, ETC. (Contd.)

In certain situations, the firm also furnishes human readable source code. The source code and other source materials allow the customer to modify the master chip's object code before reproducing the chip. The firm makes a one time flat fee for the license of the source code and restricts the licensee from selling, licensing, sublicensing, disclosing, or providing access to the source material.

The exclusion from tax contained in Regulation 1502(f)(1)(B) embraces both the source code version and the object code version. The licensee who receives the source code and other source materials acquires the information incidental to the licensing transaction. As long as the licensee acquires the right to reproduce and distribute copies of the program in object code format, and does not acquire a site license for the object code, it makes no difference that the licensee does not have a similar right with respect to the source code. 9/30/88.

120.0563.950 **Special Employees v. Independent Contractors.** In determining whether a taxpayer is making taxable sales under Regulation 1502(f)(2) or is merely furnishing ''special employees'' to its customers, the distinction between special employees and independent contractors must be drawn. Of the factors entering into this distinction, the primary one is whether the person for which the work is being done has the legal right to control the manner and means of accomplishing the results desired. Other factors to be considered are:

(1) Whether the one performing the services is engaged in a distinct occupation or business,

(2) Whether in the locality, the work is usually done under the direction of the principal or by a specialist without supervision; the skill required in the particular occupation,

(3) Whether the principal or the workman supplies the instruments, tools and place of work,

(4) The length of time for which the services are to be performed,

(5) The method of payment (time spent or by the job),

(6) Whether the work is part of the regular business of the principal, and

(7) Whether the parties believe they are creating the relationship of employer-employee. 11/22/77.

120.0564 **"Special Employees"—Keystroking Services.** The performance of keystroking services to enter data from source documents to magnetic computer disks for a customer is taxable fabrication labor unless the services are performed by ''special employees'' on the customer's premises. The distinction is whether the taxpayer is engaged to produce a finished product, or to provide personnel who will work under the direction and control of the customer.

In this instance, the taxpayer's people were involved in handling the overflow of work normally done by the customer's staff and the customer's office manager assigned the tasks to be done. The supervisor provided by the taxpayer was only required when there were six or more temporary employees on a shift, and the contract specified that the work would be done ''. . . as requested and directed

by . . . (the customer).'' Under these circumstances, the keystroking services were performed by ''special employees'' and the charges were not subject to tax. 12/19/79.

120.0564.500 **Stock Quotations by Modem.** Charges for modem to modem stock quotations are not subject to tax where there is no transfer of any tangible personal property. 11/29/93.

120.0565 **Subcontracting Custom Computer Program.** If a seller contracts with its customer to provide a custom computer program to the customer's special order and then subcontracts with another person who creates the program to the special order of the seller's customer, sales tax would not apply to the seller's charge to the customer for the custom computer program. 8/23/93.

120.0575 **Sublicense of Software.** A taxpayer obtains canned software from its lessor under a licensing agreement which that taxpayer will sublicense to its customer. The lease agreement requires a primary license charge plus annual license charges. Under the terms of the licensing agreement, if the annual license charge is not paid, the taxpayer must discontinue use of the product and return all copies to the lessor.

If the taxpayer transfers to its customer the actual software it obtains from the lessor and if the agreement requires that actual software be returned if the license fee is not paid, the transfer to the customer is a sublease under Regulation 1660(c)(5). The sublease is subject to use tax measured by the subrental payments unless the taxpayer makes a timely election to pay its lessor use tax measured by the rentals payable under the prime lease. (See Annotation 330.2170.)

If, however, the taxpayer were to retain the original media which it receives from the lessor and make a copy for lease to its customer, the taxpayer would be using the software obtained from the lessor and not leasing it. As a result, the transfer to the taxpayer of the original media would be a taxable retail sale under section 6006(g)(5) and the taxpayer's transfer of the copy to its customer would also be taxable because the software transferred to the customer would not be the same media that the lessor acquired from the taxpayer. 6/22/95.

120.0600 **Title Clause for Special Tooling.** A manufacturer and retailer of printed circuit boards incorporates a title clause in the quotations given to its customers stating that title to all tools and computer programs, purchased or manufactured specifically for the contract which are used in the production or the testing of products, passes to the customer prior to the time the tools and computer programs are used by the seller.

Under these facts, the seller transfers title to the tools and computer programs to its customer prior to use in the manufacturing process. The seller may issue a resale certificate to its vendor to purchase the tools ex-tax. 8/23/93.

120.0650 **Trade-in of Software.** A retailer offers a promotional discount/trade-in whereby the customer was forced to give up his current software in order to obtain the company's so-called promotional discount. An agreed value between buyer and seller was reached as to the value of the traded in software.

AUTOMATIC DATA PROCESSING, ETC. (Contd.)

When a retailer accepts a trade-in, the retailer must include in the measure of tax the amount agreed upon between the retailer and the buyer as the allowance for the merchandise traded in. If there is a trade-in and also a discount, the contract between the seller and the buyer must make it clear that the parties contract for both a trade-in allowance and for a discount. 12/14/92.

120.0655 **Training Services—Sale of Software.** If sales of computer programs include training services but the purchaser does not have the option to purchase the program without the services, then the consideration paid for the training is taxable as part of the sales of the computer software, whether such charge is separately stated or not. On the other hand, when the purchaser may, at its option, contract for the services for a separately stated price in addition to the charges made for the tangible personal property, then a reasonable charge for the services is nontaxable. 12/9/93.

120.0657 **Training to Use Pre-Packaged Software—Optional.** Charges for optional training is regarded as providing of a nontaxable service provided such training is not part of taxable consultation (see Regulation 1502(f)(1)(C)). 9/24/96.

120.0661 **Transfer of Artwork by Artist via Computer.** An artist prepares artwork and places it on the artist's removable computer storage media (e.g., floppy disk). The artist takes the disk to the customer's location, inserts the disk into the customer's computer, and transfers the artwork from the artist's disk to the customer's computer. The artist removes the disk and retains it, and does not otherwise provide any tangible personal property to the customer. The transfer is not a sale of tangible personal property provided the artist retains title to and possession of the disk at all times. For example, if, after inserting the disk and prior to its removal, the artist leaves the computer and the customer uses it, the artist would be regarded as making a taxable lease of the disk. 7/22/96.

120.0661.175 **Transfer of Artwork—External Storage Diskettes.** When an artist creates artwork on a client's computer and saves the artwork into the computer's memory, the artist's charge is nontaxable. In this situation, the artist does not transfer tangible personal property to the client. The same result is not reached when the artist transfers the artwork to external storage diskettes or disks and transfers them to the client, whether the client or the artist furnishes the removable disk or diskettes. When the artist furnishes the disk or diskettes, the artist is making a sale of tangible personal property under subdivision (a) of section 6006. If the client furnishes either new or used disks or diskettes, the artist's charge for the work performed to create the artwork is a sale as defined in subdivision (b) of section 6006. The artist's charge for the sale, whether under subdivision (a) or (b) of section 6006, is subject to tax. 12/2/96.

120.0662 **Transfer of Illustrations via Computer Modem.** Tax does not apply to the transfer of illustrations by computer modem and when seller does not provide its customer with any tangible personal property. 04/18/96.

120.0663 **Transfer of Images by Electronic Means.** A taxpayer prepares advertisement layouts and transfers the image of the advertisement by modem to its client, or the taxpayer posts the advertisement on the Internet.

AUTOMATIC DATA PROCESSING, ETC. (Contd.)

Sales tax does not apply to the taxpayer's charge because the taxpayer does not make a sale of tangible personal property when information is transferred by electronic means. On the other hand, if the taxpayer provides the client with a hard copy of the advertising layout or transfers the layout to the client on a computer diskette, the charge is subject to sales tax. 3/12/96.

120.0665 **Transfer of Information from One Tape to Four Others.** A firm is in the business of manufacturing and embossing credit cards for financial institutions. The information to be embossed is obtained from the financial institution on a data processing tape. Occasionally the firm's equipment cannot read the financial institution's tape because it is incompatible with the firm's equipment. In order to make it compatible with its equipment, the firm transfers the information on the tape to four tapes. In these cases, it makes a separate charge to the financial institution for ''interim tape processing.''

This charge is not a charge for processing customer furnished information as described in Regulation 1502 (d)(5). The contract with the financial institution is a contract to produce credit cards. The restructuring of the information is merely one step in the manufacturing process. The separately stated charge is part of the gross receipts from the manufacture of the credit cards. 5/13/93.

120.0667 **Transfer of Program into Escrow.** Corporation A sold all of its assets, including software, to Corporation B. The programs were transferred by network wire. The programs were designed to be used by banks and were written for the purpose of selling to banks and other financial institutions. For unknown reasons, the software was not marketed. The original master disks were retained by Corporation A, but were required under the contract to be stored in escrow. They were to be available to Corporation B for a period of five years to verify the accuracy of the wire transfer. Corporation A was barred from using, making copies of, or permitting other persons access to the disks. At the end of the five-year period, Corporation A was required to erase the disks.

The transaction is regarded as including the sale of the master disks since Corporation B obtained all of the rights of ownership except custody. The transfer of the disks was, however, not taxable because Corporation B purchased the software to obtain the right to reproduce or copy a program to which a federal copyright attaches in order to publish and distribute it for consideration to third parties. That is, subdivision 1502(f)(1)(B) is not limited to leases for copy and sale, but also to transfers of title for such purposes. It is immaterial that Corporation B may have later decided not to market the program. 10/29/87; 2/18/92. (Am. M99–1).

120.0669 **Transfer of Software Documentation.** Taxpayer is in the business of developing and selling software. All sales of its product includes documentation. Customers will receive their documentation in one of three formats: paper copy, CD ROM, or via remote telecommunications. When the documentation is delivered either via CD ROM or electronically, it contains a search engine. The search engine enables a key word search of the documentation only and does not work on the software itself and is in no way an enabler of any of the actual software capabilities.

AUTOMATIC DATA PROCESSING, ETC. (Contd.)

Regulation 1502(f)(1)(D) provides that the seller of a prewritten computer program transferred electronically is the consumer of property used to produce written documentation or manuals designated to facilitate the use of the program where the documentation or manuals are transferred with no additional charge. If a separate charge is made, then tax applies to the separate charges. Also, tax does not apply when the documentation or manual is transferred electronically to the customer since the customer will not receive any tangible personal property. The taxpayer is the consumer of the documentation and/or manual.

When a customer receives a CD ROM, it contains both documentation and a search engine. The search engine consists of prewritten software designed to provide access to the information contained on the CD ROM. Accordingly, the taxpayer is selling tangible personal property containing prewritten software in the form of a search engine. Its charge for that software is subject to the tax and is measured by either the taxpayer's separate charge for the search engine (provided it is not artificially low in order to avoid tax), or on the portion of the taxpayer's overall charge allocable to the sale of the prewritten software (i.e., the search engine) transferred in tangible form. 5/29/97.

120.0670 **Transfer of Software Program.** A software firm transferred the right to reproduce and copy a software application program to which a federal copyright attaches for a lump sum payment in order for the purchaser to publish and sell the program. Approximately ten days prior to the closing date of the purchase, the seller began transmitting the software program to the purchaser via electronic transmission to and through the purchaser's computer.

For technical reasons associated with the purchaser's plan to republish the software programs for sale to distributors and end-users, the purchaser would now like to take delivery of tangible media containing the software programs from the seller.

Under the facts provided, the seller's transfer of the program by electronic means was for the purpose of transferring the encoded data to the purchaser in order for the purchaser to copy and sell the program. Furthermore, the receipt of the program by remote telecommunications is not subject to sales or use tax. (Regulation 1502(f)(1)(D).) The seller's transfer of tangible media at a date later than the original transfer is for the purchaser to make a functional use of the media rather than to merely transfer the right to reproduce; the transfer of the right to reproduce had already occurred. Therefore, if the purchaser makes a further payment to the seller, the transfer of the tangible media would be subject to tax measured by the seller's charge for the media.

However, if no further payment is required, tax would not apply to the seller's subsequent transfer of a tangible copy of the program together with the granting of the rights to reproduce or copy the program in order for the program to be published and distributed for a consideration to third parties. The transfer of the storage media would be regarded as incidental to the granting of the right to copy and sell the program. (Regulation 1502(f)(1)(B).) 2/17/95.

AUTOMATIC DATA PROCESSING, ETC. (Contd.)

120.0760 **Unlock Code Fee.** A taxpayer sells CD-ROM disks which embody software programs. The purchaser of the disk has access only to certain programs on the disk, but may examine demonstrations of other software on the disk. The taxpayer has an ''800'' telephone number which the purchaser may call and pay a fee to obtain an unlock code for access to other programs on the disk.

The transfer of the disk is considered a sale of tangible personal property. The payment of a fee to obtain access to a portion of the disk is a further payment for use of the disk. Tax applies to the charge for the unlock code. 5/2/95.

120.0768 **Update with Federal Copyright Attached.** Even if an update is not custom software, when a federal copyright attaches to the update, its delivery is exempt from tax where its transfer to a customer is solely for republication to third parties by the customer as part of the customer's hardware under a license agreement. 1/21/88.

120.0800 **Use of Purchased Software Program as Manufacturing Aid.** Taxpayer creates custom computer programs which are written to the special order of the customer. On some customers' contracts, taxpayer will utilize a purchased software program as a tool to help produce the finished custom program.

Tax does not apply to a custom computer program. However, use of a purchased software program as a manufacturing aid to produce the custom program is a taxable use and tax applies to the purchase of the software by taxpayer.

Charges for additional copies of the custom program and charges for design and production of disc labels, disc sleeves and disc packaging are subject to tax. 11/13/91.

120.0840 **Use of Software at a Central Location.** A multistate corporation maintains a master computer center in California. The corporation routinely purchases prewritten software from vendors who ship the disk or tape to the California center. The software is installed into the master computer center. The corporation's locations from throughout the world then log onto the master computer center by remote telecommunication and download the software to their computers. The corporation pays an initial amount for the right to use the program at a stated number of locations. It also agrees to pay an additional fixed price for each additional location.

The programs are installed and used in California regardless of the location of persons who have access to the master computer. Tax applies to the initial amounts, the amounts paid for additional locations, and program updates if the programs purchased are transmitted to the master computer center in tangible form.

Tax does not apply to contracts to transmit updates to the master computer center by remote telecommunication, provided that the updates are, in fact, transmitted by remote telecommunication with no transfer of tangible personal property. However, the application of tax to such contracts would not affect the

application of tax to contracts, such as the initial purchase and previous update contracts, which provided for the transfer of tangible personal property such as storage media. 11/21/94.

120.0855 **Use of Software—Transmittal by Remote Telecommunication.** If a seller purchases a software program on disk for resale and transmits the contents of the disk to the customer by remote telecommunications, the seller has made a taxable use of the program and owes use tax measured by the cost of the program. 2/21/97.

120.0900 **Word Processing Services.** Gross receipts from a contract to provide word processing services, when the product is either on a diskette or hard copy, are nontaxable. The person who provides the word processing is the consumer of, and tax applies to the sale to that person, of tangible personal property which they transfer to their customers incidental to the service. If the contract requires only a diskette or a hard copy, the sale of another copy, either in diskette or hard copy form, is a sale of tangible personal property to which sales tax applies. If the product is a combination of composed type and illustrations, tax applies to the total charge attributable to those pages which contain illustrations. 8/23/93.

120.0905 **Written Documentation in Connection with Software Transferred by Remote Telecommunications.** Tax does not apply to the charge for the transfer of software via a network bulletin board irrespective of the later incidental transfer of written documentation. The later transfer of written documentation will not convert an otherwise nontaxable transaction into a taxable one. Since the function of the written documentation is simply to facilitate the use of the computer program, the transfer of the documentation is incidental to the true object of the transaction, which is to obtain the computer program itself. 3/29/85.

120.0925 **Furnishing of a Computer System and of Images on a Disk.** A taxpayer furnishes a computer system to a customer. The taxpayer also digitally stores images on disks in a camera and either furnishes the disks to the customer or installs the information from the disk onto the computer which is in the possession of the customer. The parties regard the arrangement as a service agreement.

Regardless of what the agreement is called, the transaction is a lease of the computer system and a sale of the disk. 11/3/94.

120.0930 **Interactive Presentations.** Interactive corporate training and sales presentations which are delivered to customers on computer disks or CD ROMs and run on automatic data processing equipment qualify as computer programs. If the interactive presentation is completely designed for a particular customer (custom program) rather than a modified prewritten program, the sale would not be taxable. If an existing program is modified, sales or use tax applies to the charge for the presentation. However, tax does not apply to separately stated charge for modification made to the program for the customer. On the other hand, if a separate charge is not made for modifying an existing program, tax applies to

the entire charge made to the customer unless the modification is so significant that the new program qualifies as a custom program based on the following criteria:

(1) If the prewritten program was previously marketed, the new program will qualify as a custom program if the price of the prewritten program is 50 percent or less of the price of the new program.

(2) If the prewritten program was not previously marketed, the new program will qualify as a custom program if the charge made to the customer for the custom modifications is more than 50 percent of the contract price to the customer. (Regulation 1502(f)(2)(B)). 6/20/95.

(b) PROCESSING CUSTOMER FURNISHED INFORMATION

120.1115 **Analysis Services in Connection with Sales of Software.** A taxpayer sells a complete package of software which includes the software system, a user's guide, periodic updates of the software, and an analysis of monthly data submitted to the taxpayer by the customer.

The software and the updates are tangible personal property and subject to tax. While the analysis of monthly data is the ''processing of customer's furnished information,'' it remains part of the sales price of the software. These ''services'' represent services that are part of the sale of the software which the customer cannot acquire without also obtaining the ''services.'' 6/24/91.

120.1155 **Birthday Notices—Restaurant.** A firm receives registration forms from a restaurant. It enters the data on a disk and sends it to a data processing service bureau which maintains a file of the customers. Each month the service bureau prepares a tape of customers who have birthdays during the month. The tape is sent to a laser printing firm which prints the name and addresses on cards. In some cases a message is added. The charge by the printing firm is the same whether or not a message is added.

The laser printing operation results in a sale by the firm to its customer when the printer prints the names, addresses and a message. Any printing beyond the name and address subjects the entire charge to tax including charges for maintaining the customer's file.

On the other hand, if only the name and address is printed, the transaction is nontaxable as a mailing service. The addition of a salutation (Dear------) would not make the addressing taxable. 3/1/84.

120.1160 **Computerized Services.** A taxpayer provides certain computerized services for automobile service stations. The client is provided with work order forms, mailers, and certain other supplies. The client sends a copy of the work order on each lube job, etc., to the taxpayer weekly. The customer's name, address, car mileage, type of work, etc., is taken from the work orders and entered into a computer. The computer produces an immediate ''thank you'' card which is sent directly to each client's customer. The client receives a monthly customer listing printout, alphabetized and in zip code order, showing various data such as work order breakdown, employee production, etc. The taxpayer charges a

one-time fee for computer set up, work orders, and supplies. Thereafter, there is a charge per card mailed, a charge per page for the customer listing printout, and a monthly charge for management fee, plus shipping charges.

This taxpayer is processing customer furnished information when it inputs information from client work orders and produces a monthly report from this information showing customers listed in either alphabetic or zip code order, types of service, etc. It has been held previously that listing by zip code, for example, is regarded as more than ''reformatting'' as that term is used in Regulation 1502. Moreover, the information provided states that other tabulated information is available.

The taxpayer is the retailer of the cards it prints and sends to the client's customers and the charge made for printing the cards is also subject to tax. Since the taxpayer makes a single charge which includes the printing and postage and mailing services, it is entitled to make some segregation of the total charge per Regulation 1504(e)(2). 5/17/82.

120.1162 **Conversion of Customer Furnished Information.** Company A, an out-of-state service bureau, processes client's computer tapes on its computer/microfiche processor to convert customer furnished information to microfilm. Company A claims to have no representative nor any operations in California. However, it does hold a Certificate of Registration—Use Tax for California. Tapes and microfilm are received and sent by mail.

The service provided is the conversion of customer-furnished data from one physical form of recordation to another physical form of recordation. Thus, Company A is regarded as selling microfilm and tapes to its customers (Regulation 1502 (d)(l)). When the retail sales of these items are made to customers for delivery into California, the use tax applies. Since Company A holds a Certificate of Registration—Use tax, it is regarded as a retailer engaged in business in California and required to collect the use tax. 12/12/90.

120.1165 **Copies of Reports.** A taxpayer processes data for its customers and furnishes reports. The initial copy of each report is regarded as being furnished incidental to the service of processing and tax does not apply. The initial copy may be printed on paper, microfiche, or carbon copies produced simultaneously with the initial typing. Second and subsequent copies produced by printing are not regarded as being incidental to the performance of the service because they are not produced simultaneously with the original copy.

The taxpayer also furnishes its customers with real estate loan cards and perforated index cards. The real estate loan cards include the debtor's name and address, principal amount, interest rate, periodic payment amount, and other data calculated by processing customer-furnished information (e.g., delinquent amounts). The index cards are imprinted with summaries or extracts of information obtained from its files (e.g., interactive accounts). Tax does not apply to any item resulting from processing of customer furnished information. However, tax does apply to any item which is essentially printed to the order of

the customer and does not involve processing of the information, such as gummed labels containing computer generated unassigned account numbers. 6/26/87.

120.1170 **Coupon Books.** A taxpayer contracts to maintain records or accounts receivable for clients. Some clients desire that coupon books be prepared to show on each coupon the amount to be paid each month by the client's customers. The coupons are usually for a 12-month period. The amount may vary during the same 12-month period. The taxpayer produces the coupon books with electronic data processing equipment, places the books in envelopes and mails them to the client's customers. A separate charge is made for each book. The preparation of the coupon books is regarded as the same as preparing customer invoices. The taxpayer is providing a billing service for its clients. Tax does not apply to the charges for the coupon books. 7/22/77.

120.1174 **Data Base Access.** A taxpayer maintains a data base and sells computer access to its banks. The participating banks provide operating statistics. The taxpayer merges statistics from its client banks and provides tabulations on paper to them. The operation is not the exempt processing of customer data because the tabulations furnished to an individual bank are not limited to the data supplied by that bank. Tax applies to the charge for the printed tabulations. 9/7/82.

120.1175 **Data Processing.** Charges for the same data processing activities, e.g., data entry and verification, etc., may be taxable or nontaxable depending on the means of transferring the finished product to the customer. If the customer receives the data on storage media such as tape or disk or other media constituting tangible personal property, the charges are subject to tax. If the data is transferred electronically (modem to modem) to the customer's computer and no tangible personal property is transferred, there has been no sale and the tax does not apply. 4/29/94.

120.1178 **Demographic Report.** A firm obtains market survey cards completed by its client's customers. It encodes the information and provides the client demographic information about its customers. The information furnished to the client may be printed or on a floppy disk. The contract for these reports is for nontaxable service of processing customer furnished information. 3/30/89.

120.1180 **Design of Image for Software.** A taxpayer contracts to design an opening screen for a software product that its customer will market to the public. The taxpayer will give the customer the file electronically and the customer will program it to be interactive.

For another customer, an Internet service provider, the taxpayer contracts to design a ''Home Page''. The customer will be provided with an electronic file for it to manipulate and make interactive.

When a taxpayer sells a design to a software retailer who will use the image as an opening screen for software it sells, the taxpayer's sale is not a sale for resale. When a taxpayer sells a design to the software retailer, the software retailer does

not sell that design to another person; rather, the retailer uses the design by recreating the image on its software. The taxpayer's sale of the design to the retailer for that purpose is a taxable retail sale. Similarly, the taxpayer's sale of a design to the Internet service provider to use as a home page is a retail sale subject to sales tax.

However, if the design is transferred to the customer electronically by fax or modem and the taxpayer does not transfer any tangible personal property such as storage media to the customer, such a transfer is considered to be an electronic transfer of information and not a sale of tangible personal property. Sales tax would not apply to the charge in such cases. 5/12/95.

120.1200 **Digitized Photographs.** A corporation takes color photographs of homes which are being offered for sale. It digitizes the photographs and provides them to a real estate multiple listing service which furnishes them to its members. If the corporation provides the digitized photographic images on disk, tape or other storage medium, the transfer is a retail sale subject to tax. If the transfer is by remote telecommunication, such as by modem, tax does not apply. 7/14/94.

120.1220 **Digitizing Audio and Video Tapes.** A taxpayer converts customer-furnished information stored in analog format on tapes (e.g., VHS, Hi8) into digital format on computer disks. The taxpayer's charge for the computer disks containing the digital files is taxable. 7/2/97. (M98–3).

120.1325 **Fingerprinting—Construction of a Mathematical Model.** The customer provides a fingerprint and the taxpayer translates it into a digitized image. During this step a mathematical model of ''minutae'' derived from the image of the fingerprint is created. This process is considered nontaxable development of original information from customer-furnished information under Regulation 1502(d)(5). ''Minutae'' refers to the location and interrelationship of those critical points within the fingerprint that allow fingerprint matching. 7/9/90.

120.1800 **Letters to Mythical Characters.** A company produces response letters to send to children who write to mythical characters. Each letter will be comprised of both a section of original text and a section of text which will be generated by assembling the appropriate paragraphs from a pre-existing paragraph library. Some of the pre-existing paragraphs will be modified slightly to insert variable information to personalize them. The company's pre-existing data base will also include illustrations to be incorporated into each letter.

The company is not sending professional services nor is it transcribing services of someone else. The company's response letters are taxable as multiple copies. The letters do not qualify for exemption as processing of customer furnished information. 5/9/91.

120.2000 **Magnetic Storage Media Transferred.** When a word processing service records a customer's manuscript on customer-supplied data processing media or taxpayer-supplied data processing media, tax applies to the charge when the data processing media is transferred to the customer. If the word processing service also transfers a reading copy (printed copy) of the manuscript along with

the media and the customer is charged a lump-sum price, tax applies to 50% of the amount charged which represents the charge for the media.

The encoding of the manuscript on data processing media is similar in concept to the keyboarding services involved in the case of *Intellidata, Inc.* v. *State Board of Equalization,* 139 Cal.App.3d 594. While the typing of a manuscript is a service, the furnishing of the encoded media is the sale of tangible personal property. Since an equal amount of effort had gone into the two objects of the contract, a 50% apportionment is appropriate. 8/26/86.

120.2620 **Maintenance of Library Data Base.** A contract calls for a data processor to continuously maintain and update a data base owned by a library. In addition the contract also requires the processor to expand the data base to encompass the conversion of records to a new national standard library format. Under these circumstances the data processor is providing a nontaxable service for the processing of customer furnished information. (Regulation 1502 (d)(5)). 11/29/89.

120.2635 **Microfiche Copies.** A data processing service bureau provides processing services in microfiche form. The customers furnish information on various transactions which is processed to produce a magnetic tape. The tape is further processed to develop a negative which is called the ''master copy.'' The company then makes one or more microfiche copies from the master copy. The master negative is retained by the company from one to six months, after which time the customer has the option to receive it at no extra charge or it is disposed of by the company.

With regard to the data processing service charge, tax does not apply to the charges made for the data processing as well as the production of both the master negative and the first microfiche copy which is made from the master negative and transferred to the customer. These charges are for the rendition of the nontaxable service. The charge for any additional copies of the microfiche furnished to the customer is subject to tax. 5/18/84.

120.2779 **Processing Customer-Furnished Information.** A taxpayer receives documents from a client which are inputted into the computer using a scanner. The taxpayer then extracts, manipulates, and sorts the data from the documents according to the contracted instructions of its client. The data is then written onto an output medium, CDs (compact disks). The taxpayer makes a separate charge to its customer for the cost of the compact disks used to transfer the original information developed by the taxpayer. The taxpayer also makes a separate charge to its customer for pick-up and delivery of the customer-furnished documents and the compact disk containing the original information developed by the taxpayer.

The extracting, manipulating, and sorting data furnished by the taxpayer's customers, and the updating of a continuous file of information maintained by the customer, constitute a nontaxable processing service under Regulation 1502(d)(5). Accordingly, the charges for this service are not subject to sales tax. The separately-stated charges for the cost of the compact disks used to transfer

the original information developed by the taxpayer are subject to the sales tax. Regulation 1502(h) specifically provides that if the data processing firm's billing is for nontaxable processing of customer-furnished information, tax will not apply to pick-up and delivery charges. Thus, the pick-up and delivery charges for the customer-furnished documents and the compact disks containing the original information developed by the taxpayer are not subject to tax. 10/31/96.

120.2780 **Processing Customer Furnished Information.** A taxpayer is in the business of automating legal documents for customers, making them easily searchable by computer, using a key word or phrase. The documents are first scanned into a computer and temporarily stored on a disk. The scanned images on the disk are then placed into a laser data format, and the printed words changed into an ASCII text file. A high speed computer software then indexes each word into a database and cross references it back to the original document.

If all the taxpayer did was convert the customers data from paper documents to computer storage, the charge for the conversions would be subject to tax. However, creating an index is considered a sorting and sequencing function, which are examples of nontaxable processing of customer-furnished information. Regulation 1502 (d)(5)(E) does not require an allocation between operations, which if performed by themselves would be taxable from those that are nontaxable; rather, as long as customer furnished information is processed, the entire transaction relating to the copying and processing of the original information is nontaxable. However, additional copies of records, reports, tabulations, and storage media are taxable. 1/29/93.

120.2783 **Processing Customer Information.** Customers provide their diaries or logs for processing by the taxpayer for a fee. The taxpayer returns the results in hard copy to each customer in a cost or expense summarization type format.

The taxpayer is providing a service and the transfer of the hard copy of the processed information is only incidental to the provision of the service. Thus, the charges for these services are excluded from the measure of tax. The taxpayer is the consumer of all tangible personal property which is used in providing these nontaxable services. 12/9/93.

120.2788 **Processor of Credit Card Transactions.** A processor of credit card transactions contracts with banks and airlines to process their credit card transactions. The processor receives charge account sales documents or tapes reflecting the transactions and enters the information from those documents in its computer system. The resulting charge account statements are mailed out. The processor's charges and their tax applications are set forth below.

(1) The credit card company (e.g., Visa, Mastercard) distributes lists (hard copy) of bad card numbers to merchants. The credit card company bills the credit card processor who in turn bills its customers with a mark-up.

Charges for these lists of bad card numbers are either taxable as sales of additional copies of records or tabulations pursuant to Regulation 1502(d)(5)(F) or taxable as printed matter under Regulation 1541(a), depending upon further facts.

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(2) A charge is made to the credit card processor's customers for a mailer sent to credit card holders notifying them that their credit cards have been mailed.

Charges for notices sent to cardholders are for sales of printed matter and are taxable. Charges for services rendered in preparing material for mailing are, however, nontaxable pursuant to Regulation 1504(c). The charge for the printed matter should be separately stated from the charges for mailing services. 5/22/84.

120.2810 **Seismic Data Acquisition and Processing.** When the acquisition of seismic data is accomplished by a service company's field crew and includes the extensive involvement of licensed professional engineers exercising their professional judgment in making a wide variety of decisions to assure the most accurate information possible is obtained and the product of these efforts is delivered to the customer in written report form, the true object of the contract is the engineering services and the charges are not subject to tax.

The raw data may be referred by the customer to a processing company for refinement. This procedure involves many discretionary tests and decisions to remove extraneous ''noises'' and to make the data more accurate and usable. The true object of this contract is the development, through computer manipulation, of original data from raw data furnished by the customer. This constitutes ''processing of customer-furnished information,'' which is nontaxable under Reg. 1502, as is any tangible personal property incidentally transferred therewith.

A single contract for acquisition and processing is also not taxable. 4/16/86.

120.2828 **True Object of Contract.** In addition to converting a customer's typed documents to computer readable form by means of optical character recognition equipment, a taxpayer also performs certain ''processing of customer-furnished information'' services such as deleting headnotes, footnotes, or handwritten notes, and the resequencing of pages provided by the customer. Although these latter services are in the nature of processing of customer-furnished data, they are of minimum significance in relation to the end product of computer readable media. The true object of the contract is the conversion of the data from one medium to another, which is a taxable event pursuant to Regulation 1502. 5/30/91.

120.2850 **Updating Medical Files.** A computer service firm receives from a customer's nursing facilities the handwritten patient records reflecting physician's orders, plan of care, etc., for the subject patient. The firm enters the information into its computer, creates a file on the patient, and prints out the various patient chart forms requested by the customer. As changes in the physician's orders, plan of care, etc., are made, the facility transmits the information in writing to the firm. The firm enters the new data into the computer and merges it with the patient's file. The firm prints the new forms with the revised patient information and sends them to the customer.

The activities described qualify as processing of customer furnished information because a file of information is maintained on the patient which is periodically updated to reflect reported changes. (Regulation 1502(d)(5)). Therefore, the medical data processing activities qualify as services not subject to tax. 6/30/82.

AUTOMATIC DATA PROCESSING, ETC. (Contd.)

(c) CUSTOM PROGRAMS

120.3044 **Basic Operational Program—Custom Computer Program.** A ''basic operational program'' as defined in section 995.2 of the Revenue and Taxation Code means, among other things, a computer program which is fundamentally necessary to the functions of a computer, and is specifically excluded from the definition of a custom computer program. By contrast, application programs are not basic operational programs. Under section 995.2, MS-DOS, OS/2, and UNIX are basic operational programs. APPLETALIC may or may not be a basic operational program, depending upon whether it is an integral part of Apple Computer's operating software. Whether any particular utility program is or is not a basic operational program would depend upon whether it meets the section 995.2 definition. These definitions of basic operational programs are used in determining whether a computer program is a ''basic operational program'' as that term is used in Regulation 1502.

If custom modifications to a basic operational program are developed, sales or use tax applies to the charges if the modifications are transferred on storage media to the customer. If an entirely new custom computer program is developed which is a basic operational program, sales or use taxes will apply to the charges if tangible storage media is transferred to the customer. 9/18/89.

120.3045 **Computer Programming Activities.** A company engaged in developing and selling computer programs entered into an agreement with a number of local government entities to perform certain computer programming activities related to the maintenance of a computerized data system. The computer program was originally developed by one entity and was eventually adopted for use by 14 entities. The issue is whether the company sold or fabricated custom computer programs for a single entity or whether the company prepared prewritten computer programs for repeated sales to various entities.

The entities involved joined together to execute a single contract with the company. All instructions were issued by a Joint Committee representing all of the entities and which acted as the executive body for the group. The evidence supports a finding that the entities formed a joint venture for the purpose of contracting with the company for computer programs. The company was, therefore, providing computer programs to the special order of a customer, the joint venture, and did not prepare computer programs for repeated sales or lease to the individual entities. Under section 6010.9, the company's programs were custom programs the sales or leases of which are not subject to tax. It is immaterial that payment to the company was made by individual members of the joint venture. The payments were allocated and made in accordance with the contract which set up the joint venture. 7/6/83.

120.3050 **Computer Programs Used to Operate Grading, Sizing, and Marker Making Machines.** Grading and sizing involve adjusting the size to scale for different size garments for each of the components of the prototype garment. Marker making is determining the most efficient way for a manufacturer to cut raw cloth to minimize losses to scrap. Persons who create the programs that

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operate these machines perform their design work using computer software. The finished product is downloaded on diskettes and then transferred to the customers for use in operating their machines.

Persons who create and transfer designs on diskettes which are used to operate grading, sizing, and marker making machines are performing custom computer programming if the designs are prepared to the special order of the customer. Accordingly, the transfer of custom design on diskettes which are used to operate such machines constitutes nontaxable sales of custom computer programs. 6/23/97.

120.3055 **Computer Program Translation Services.** The translation of customers' computer application program codes to make the programs useable on a different brand of equipment is custom computer programming excluded from ''sale'' and ''purchase'' tax as it meets the criteria of modification to an existing program pursuant to section 6010.9(d). However, the translation of file records or data does not qualify for exclusion from that definition as they are not programs as defined in section 6010.9. They are also not exempt services as the true object of the contract is the property produced by the translation service and not the service per se. Charges for this service are subject to sales tax. 9/25/85.

120.3080 **Custom Computer Programs.** The determination of whether a computer program is a custom computer program must be made on a program-by-program basis. When the taxpayer transfers a group of programs, some of which have been modified, he/she bears the responsibility to demonstrate which programs have been modified, in order to determine whether the modifications are of sufficient magnitude to qualify each modified program as a ''custom program'' per Regulation 1502 (f)(2)(B). 8/23/93.

120.3084 **Custom Computer Software.** A taxpayer sells computer software in connection with its sale of computerized branch exchange (CBX) systems. Each CBX is configured to meet the customer's unique requirements. Information on the number of lines, the actual extension number, and the type of devices on each line (console, terminal, plain phone, feature phone, etc.,) must be embedded in the CBX software. The public phone network system trunk, carrier (AT&T, MCI, Sprint), WATS, FX, or TIE lines which are to be connected to the CBX must also be programmed. Further, the CBX has a myriad of optional features which require software applications.

Assuming none of the software is a ''basic operational program,'' if the taxpayer substantially modifies prewritten software consisting of the ''skeletal'' make-up for all CBX systems in order to provide its customer with a unique CBX system, sales or use tax does not apply to charges for modifying this software when these charges are separately stated on the sales invoice to the customer. When the charges for customizing the software are not separately stated, tax does not apply to sales of the modified software only if the charge for customizing the software is more than 50 percent of the contract price for the CBX software. (Regulation 1502(f)(2).) 8/7/95.

AUTOMATIC DATA PROCESSING, ETC. (Contd.)

120.3086 **Custom Program Lease Receipts.** A company designs and leases computer software for the pension service industry and provides consulting services for that industry. Since the company's prewritten systems must be modified to conform with the customer's particular hardware and unique application needs, each California customer who purchases a license to use the system pays a license fee that is comprised of two separately stated amounts: a charge of $450 for the basic prewritten system, and a charge of $475 for custom modifications to that system. The decision to charge on a flat rate basis was so that all customers would be aware and would be able to plan for their cost of the service. The company stated that because there is a flat rate charge for custom programming, there is a point beyond which customization is not provided. Therefore, it is common to have separate charges for data conversion.

The agreed price, as opposed to market value or some subsequently revealed price, dictates the appropriate sales and use tax treatment. Thus, the price charged for the basic prewritten system is the measure of the gross receipts. Regulation 1502 provides for an evaluation of whether or not there is a substantial modification only in the case of a charge for a custom program that is not separately stated. The charge in this case is separately stated. The law does not require that a business charge for its product in any specific fashion. It is reasonable that if the company is working under a flat fee concept, there must be a limit to the service it provides. The provision in the contract that protects the company from having to provide customization that was outside the scope of the norm amounts to a ''safety valve'' for the company to use in the event the customer desires service that goes beyond the scope of that which is presumed by the parties. Given these facts, there is no requirement for the company to charge on an hourly basis and the company has complied with the letter and intent of the law. Tax is due only on the flat fee charged for prewritten program. 5/25/91.

120.3088 **Custom Programming Included in Sale of Computer.** Where custom programming is furnished with computer equipment under a lump-sum contract, a reasonable allowance for the nontaxable custom programming must be made. The legislative finding that accompanied the enactment of section 6010.9 stated that sales of custom computer programs are service transactions not subject to tax and that the media used is only incidental to the true object of the transaction. The allowance mentioned above should not be given if the programming consists of modifications to a canned program. In such cases, section 6010.9(d) requires a separate charge for the modifications made. 11/13/84.

120.3090 **Custom Programs.** A specially developed version of a prewritten computer program made to function for the first time on a computer's basic operational system is a custom program if the prewritten program version will not function on that operational system. This is the case even though the prewritten versions may have varying degrees of source and object code similarity with the developed version. The reservations by the developer in the license agreement (pursuant to which the specially developed software is transferred) of the right to relicense and deliver that developed version to another customer will not affect it being a custom program.

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The delivery of any modifications, enhancements, or upgrades to the specially developed version of the program for a first-time transferee will qualify as modifications of a custom program or a custom program if the prewritten modifications, enhancements, or upgrades will not function on the first-time transferee's computer system. 1/21/88.

120.3100 **Customized Computer Programs.** A company claimed that the software it sold qualified as customized computer programs, because they contained information unique to each customer. The unique information included the tax rate in the buyer's state, passwords, telephone numbers, provider numbers, hospitals, specialties, social security numbers, federal identification numbers, insurance forms utilized, office locations, and fee schedules.

The work of adding customer names or file headings to an existing computer program does not make the program a custom program. No separate charge was made for customizing the program, nor was there any evidence that the cost of the customization was more than 50 percent of the total contract price (See Regulation 1502 (f)(2)). The determination that the program sold by the company was prewritten, was further bolstered by the fact that more than one-half of the programs they sold, were sold for the same price. The price charged was too low to provide for the effort of creating a new custom program and the set price was indicative of a prewritten program rather than a custom program. 11/6/92.

120.3115 **Customizing Programs.** The encoding of the name and address of the purchaser and the utilization of this information throughout the program for purposes of display or printing on forms, statements, reports etc., is not the creation of a custom program. The sale of a basic program is subject to tax. Separately stated charges for tailoring the program with the purchaser's name and address are nontaxable as custom modifications. 3/14/83.

120.3175 **Developing Software Program.** A and B enter into a contract whereby A will assist B in developing computerized systems and data bases generally known as an Expert System (system that uses artificial intelligence techniques). Both parties are to provide their expertise and knowledge in their particular field to the venture. All ideas, inventions, hardware, firmware, software or documentation, whether or not protectable by copyright, patents or trade secrets, developed in the performance of the services will be jointly owned.

Under this scenario, the agreement is one for services only and not for services which are a part of the sale or lease of tangible personal property. Of course, if any tangible personal property is transferred by A to B in connection with the performance of this contract, tax would apply to those charges. For example, the contract calls for third party products to be transferred without mark up.

Under a provision of the contract, A will transfer to B a copy of any knowledge base developed. This transfer would take the form of tangible personal property, such as tape, disk, or other magnetic storage media. Such a transfer of storage media would be merely incidental to the performance by A of the service of developing the knowledge base and not a sale of tangible personal property.

AUTOMATIC DATA PROCESSING, ETC. (Contd.)

It is also possible that an ''Expert System'' developed by A and transferred to B might be considered a computer program as that term is defined in section 6010.9(c). If it is a computer program, rather than data or information, it would nevertheless be a nontaxable custom computer program under section 6010.9, since it would be prepared by A to the special order of B pursuant to the agreement. Thus, A would be considered to be providing the service of developing the custom program, rather than selling the program. 7/21/88.

120.3190 **Diskettes Used to Operate Embroidery Machines.** Regulation 1502 provides that tax does not apply to the sale or lease of a custom computer program, other than a basic operational program, regardless of the form in which the program is transferred. Persons who create designs and transfer the design in machine-readable form to operate embroidery machines are performing custom computer programming services if the designs are prepared to the special order of the customer. In other words, the preparation of punched paper tapes and diskettes used to control the operations of embroidery machines for such purposes constitutes nontaxable custom computer programming under section 6010.9. 3/25/97.

| 120.3380 **Multimedia Presentations.** A company designs and produces custom interactive computer-based presentations. The customers take possession and title to the products on various storage media such as floppy or compact disks, hard drives, etc. The product combines still artwork with video, animation, narration, and graphics to create a unique interactive computer presentation.

Based on the understanding that the true object of the contract is to produce interactive presentations and that the item sold is a ''program'' as defined in Regulation 1502(f)(2), the property sold is a computer program notwithstanding the artwork embodied therein. The programs did not exist at the time of the contracts and they were produced to the special order of the customers.

If a portion of one or more prewritten programs are incorporated into the completed programs and if the charge for the modifications are separately stated from the charge for prewritten portions, the charge for modifications is nontaxable while the charge for the prewritten portion is taxable. Otherwise, the entire charge is taxable unless the modification is so significant that the new program qualifies as a ''custom'' program. Tax also applies to any duplicate copies of the custom software. 9/11/92.

120.3550 **Programmable Calculator.** A programmable calculator falls within the scope of the term ''computer.'' Thus, a custom computer program other than a basic operational program will not be subject to tax even though it is designed for use by a programmable calculator. Further, this exclusion would extend to such custom programs when they are transferred in the form of magnetic cards or PROM (i.e., programmable read only memory). 12/24/82.

120.3645 **Separate Charge.** If a charge is made for a canned program and there is a separately stated charge for the modification of the canned program, only the charge for the modification is excluded from the measure of tax notwithstanding the fact that the modification represents more than 50% of the total charges. 1/31/95.

AUTOMATIC DATA PROCESSING, ETC. (Contd.)

120.3670 **Service Versus Sale.** Custom computer programs are exempted by section 6010.9 as services even when included in the sale of computer equipment without a separate itemization of the charge. A reasonable allowance for the value of such services must be recognized in determining the measure of tax of such transactions. If, however, the programs included in the sale of the equipment consist of prewritten programs modified for the needs of the customer, section 6010.9 requires that the charges for the modifications be separately stated to be exempt from tax. 11/13/84.

120.3700 **Software for Computerized Branch Exchange.** A taxpayer's major product is a Computerized Branch Exchange system (CBX). Each CBX is configured to meet the customer's unique requirements. Therefore, the software of each CBX installation is unique. The taxpayer inputs information received from its customers with respect to the customers' needs into a separate program for use in generating the software necessary to run customer's individualized CBX system. The process requires the taxpayer to modify prewritten software consisting of the general framework for all CBX systems.

Under the scenario, tax does not apply to the taxpayer's charges for modifying this software when these charges are separately stated on the sales invoice to its customers. If the taxpayer does not separately state these charges and does not market or sell the prewritten component of software, the individual CBX software is ''custom'' and not subject to tax only if the charge for customizing the software was more than 50 percent of the contract price for the CBX software. When these conditions are met, the taxpayer's sale of the individualized CBX software is not subject to tax regardless of the form in which the program is transferred (i.e., via disk, tape, or modem), whether or not the software is sold in connection with the sale or lease of computer equipment and whether or not the charges for the software are separately stated. If these conditions are not met, tax applies to the entire charge for the software. 5/8/95.

120.3920 **Test Programs.** Computer programs developed to functionally test semiconductors on testing machines constitute custom computer programs, charges for which are not subject to tax. They do not constitute programs for operating programmable manufacturing machinery or equipment because the testing machine cannot be used to make, form, fabricate, process, or assemble a product or a component or ingredient of a product. 11/10/87.

125.0000 AUTOMOBILE DEALERS AND SALESMEN—Regulation 1566

125.0020 **"Dealer Aid."** A customer looks at new models on the dealer's floor, accompanied by his salesman. Customer decides not to purchase a new car but salesman suggests the purchase of his demonstrator. After inspecting the demonstrator outside the showroom, customer purchases it from the salesman. Under these facts, assuming the demonstrator was not displayed in the showroom, the dealer is not liable for the sales tax. Mere contact with salesman in the showroom does not, in this instance constitute ''dealer aid.''

The same is true if, after looking at new cars on the dealer's floor, customer meets salesman at lunch and demonstrator is offered and accepted. 8/30/55.

AUTOMOBILE DEALERS, ETC. (Contd.)

125.0032 **Manufacturer's Rebate vs. Dealer's Incentive Or Allowance.** The manufacturer's rebate is an inducement to the consumer to purchase and is a credit available to be taken as cash or to be applied against the selling price of the vehicle. The consumer may assign the credit to the dealer. Under section 6012, the measure of the sales tax includes any amount for which credit is allowed by the dealer. The dealer collects the amount of the rebate from the manufacturer pursuant to the assignment made to the dealer by the consumer. The consumer rebate may be identified as an additional down payment or may be subtracted directly from the cash price of the vehicle. In both cases, the amount of the rebate is fully subject to tax.

As distinguished from a consumer's rebate, the manufacturer may make incentives or allowances directly to the dealers. These are inducements to the dealer to sell and are payable in the form of discounts on the cost of the vehicle to the dealer. The allowance may be a year-end close-out allowance based on unsold units. The assistance may take the form of incentive price assistance to enable the dealer to bid against competitors. The manufacturer may offer government price concessions or fleet incentives. In all of these cases the incentive or allowance is an inducement to the dealer and results in a reduction of the cost of the vehicle to the dealer. That is, there is a price adjustment between the manufacturer and a dealer as to the wholesale price of the vehicle. The actual amount of factory incentives or allowances or holdbacks may not be disclosed to consumers. In some cases, such incentives or allowances may be passed on dollar-for-dollar to the consumer and may be disclosed to the consumer whether there is intentional disclosure or not. The incentive results in a reduction in the taxable retail selling price of the vehicle, and the measure of sales tax is thus reduced. 2/24/89.

125.0050 **Sales of a Vehicle with Foreign Delivery.** Under a foreign auto manufacturer's Tourist Order Sales Program, the dealers act within the terms of the Tourist Order Limited Agency Appointment agreement. Accordingly, the dealers will be considered agents of the manufacturer. The manufacturer, engaged in business in this state, will be held responsible for the collection of use tax on tourist order sales.

Conversely, where the dealer acts as a principal in the transaction, as evidenced by documentation that indicate the dealer is acting as the seller as opposed to an agent of the manufacturer, such dealer will be considered the retailer liable for the collection of use tax. 7/10/96. (Am. 2000–1).

125.0070 **Transfers of Autos to Employees, Etc.** Transfers of autos or property by corporations to employees as a bonus, even if an annual custom and therefore expected by the employee, is a gift unless consideration such as cash or assumption of liabilities is given by the employee or there is a specific contract provision under which the employee is entitled to such property. A copy of the corporate minutes or a written statement from a responsible corporate official ratifying the gift will suffice as proof. We cannot insist on a ruling from the Internal Revenue Service or the Franchise Tax Board that they accept the transfer

AUTOMOBILE DEALERS, ETC. (Contd.)

as a gift, nor does the inclusion of the transfer as income on a W-2, 1099, or 599 has relevance in deciding if such a transfer is a sale.

Transfers to shareholders of closely held corporations are not sales if the parties follow the ''dividend in kind'' procedure (see annotation 495.0725) with both entities showing the transfer as a dividend on its books, unless the corporation receives consideration for the transfer such as cash or the assumption of indebtedness by the transferee.

Transfers to others not directly related to the corporation (e.g., daughter of sole shareholder) cannot be assumed to be sales without payment of traditional consideration such as cash or an assumption of liabilities by the transferee. 4/28/87.

125.0080 **Used Vehicles Withdrawn from Inventory for Personal Use.** When licensed dealers acquire vehicles as trade-ins from nondealers and make any use of the vehicles other than demonstration and display while holding them for sale, they must pay the use tax directly to the board. 5/12/66.

AUTOMOBILES
See Vehicles; Vehicles, Vessels, and Aircraft.

B

130.0000 BAD DEBTS—Regulation 1642

130.0005 **Cash Basis Records.** Regulation 1642 provides that all retailers must report sales tax liability on an accrual basis even if their financial records are maintained on a cash basis, and that a bad debt deduction will not be disallowed retailers solely for the reason that they are on a cash reporting basis for income tax purposes. When a taxpayer maintains its records on a cash basis, a bad debt deduction with respect to tax previously paid may be taken when all collection activities have ceased and the obligation is treated by the retailer as no longer subject to collection. In addition to the records required under regulation 1642(e), evidence of the indebtedness should be marked as ''uncollectible'' or ''bad debt'' or the records of the sale transaction should otherwise be segregated and identified for audit verification. 11/10/97. (M99–1).

130.0007 **Claims for Refund for Earned Interest on Bad Debts.** Regulation 1642, as amended September 26, 2002, allows lenders under certain conditions to claim a bad debt loss on accounts that are found to be worthless and are written off for income tax purposes. The regulation references unearned interest charges as part of the calculation for a bad debt claim using the pro rata method because unearned interest charges are specifically excluded from the ''net contract balance'' when using the pro rata method (Reg. 1642, appendix 1). The issue of unearned interest does not arise when the contract method is used. However, many claims for refund on bad debt losses include amounts for ''earned'' interest although that is contrary to the regulation. Claimants contend that in some cases, the accounts have remained on an active collection status for several years, thus the interest is ''earned'' and therefore included by inference in the measure of the bad debt loss being claimed.

Merely because the regulation specifically excludes ''unearned finance charges'' from the pro rata method, it does not follow that ''earned finance charges'' must be deductible. Lenders are not entitled to claim refunds of interest (referred to as finance charges in the regulation), earned or not, on bad debts. The regulation specifically provides that whenever a bad debt deduction is claimed, the loss is limited to amounts on which the retailer paid tax. Only the gross receipts or sales price is subject to tax; interest is not subject to tax (Reg. 1642(b)(1) and (f)(1)). Lenders have no greater right than the retailers from whom they purchased the contracts to claim bad debt deductions (Reg. 1642(i)(5)(C)). 1/9/03. (2003–3).

130.0010 **Counterfeit Money, Fraudulent Checks, Unauthorized Charge Plates.** Sales paid for by counterfeit money, fraudulent checks or use of an unauthorized charge plate are allowable reductions in sales. Losses attributable to counterfeit money or fraudulent checks in excess of the original sales amount are not allowable. 5/27/71; 5/20/96.

130.0040 **Accounts Receivable, Purchase of.** The allowance of a bad debt credit to reduce a taxpayer's liability for unpaid sales and use tax is not

permissible if the losses on worthless accounts is suffered by a party other than the taxpayer. The purchaser of accounts receivable is not allowed to take a bad debt loss on accounts he cannot collect. 1/8/65.

130.0050 **Assignment of Accounts Receivable.** A taxpayer assigns its accounts receivable to a related corporation at a 3 percent discount. There is no recourse against the taxpayer by the related corporation for uncollectibles beyond the 3 percent discount. The taxpayer cannot deduct the 3 percent as a bad debt. The selling of the accounts receivable is equivalent to a financing operation secured by the receivable. The discount is the equivalent of interest paid on a loan. 2/3/94.

130.0060 **Assignment of Notes and Accounts.** A retailer who assigns an account or note receivable with recourse, and is required to pay it off, becomes a creditor as to the amount so paid by subrogation. As long as the accounts or notes represented the sale of goods by the retailer on which tax was paid, the retailer is entitled to a bad debt loss. The account or notes become worthless in his hands at the time he is required to pay his assignee. 6/25/65.

130.0080 **Assignment of Notes and Accounts.** When a retailer sells his accounts receivable with recourse so that the retailer will bear the bad debt loss arising from his own sales, he may claim such losses as bad debt deductions to the same extent as if he had not sold his accounts receivable. 3/3/67.

130.0085 **Bad Debt Deduction.** A bad debt is ''charged off'' within the meaning of Regulation 1642(a) when it is charged off in the taxpayer's records, with intent to take that bad debt on the appropriate income tax return and not when the actual income tax return is filed. 9/20/95.

130.0090 **Bad Debt Deduction is a Credit Only.** Seller A sells equipment and reports tax on the sale. The purchaser defaults on payments on the promissory note given for the equipment and the equipment is repossessed. The equipment is then sold to a third party for the amount due on the note for the original sale.

Seller A may claim a bad debt deduction as specified in Regulation 1642 for the original sale. The fact that the second sale was for the balance of the promissory note does not exclude a tax liability for the second sale. This is a separate transaction and tax is due on the gross receipts from the second sale. 8/4/94.

130.0093 **Bad Debts.** The bad debt deduction is not limited to the retailer who reported (and paid) the tax on a sale resulting in the bad debt. The bad debt deduction extends to a successor who becomes liable for the tax on the original sale (and who suffered the bad debt) even if this person did not pay the tax resulting from that sale. Thus, a ''successor'' who is liable for any tax of the preceding retailer may take a bad debt deduction. In this way, the predecessor may make the sale and pay the tax while the sections 6811 and 6812 successor who suffers the bad debt is entitled to the deduction. 1/25/78.

130.0093.500 **Bad Debts Arising After Close Out.** The Board's practice has been to allow refunds on debts which become bad after close out. The

justification for this interpretation can be found in the first sentence of section 6055, to the effect that the retailer "is relieved from liability for sales tax . . . " The rest of the section may be taken as describing a remedy which, though available, is not exclusive. 10/30/78.

130.0094 **Bad Debts—Recovery Through Litigation.** The recovery through the process of litigation of amounts previously written off as bad debts has the same status as amounts recovered through any other process. The recovered amounts represent the sale elements in the transactions written off and are not damages recovered. Also, there is no offset for court costs or attorney's fees when the recovered amount is reported for sales and use tax purposes. These are merely collection expenses, deduction for which is prohibited by Regulation 1642(b)(2). 9/14/72.

130.0095 **Bad Debts—Retailer as Guarantor.** To facilitate the sale of equipment, the retailer agreed to guarantee the purchase note held by the bank financing the purchase. The purchaser defaulted on the note, and the retailer was required to pay it off in accordance with the terms of the guarantee. The bad debt was written off for income tax purposes. A sales tax deduction was not allowable in this situation since the loss was not the result of credit sale but rather from the guarantee contract. A retailer is entitled to a bad debt deduction for credit losses resulting from credit sales. In this transaction, the retailer received cash for the sale, with the subsequent loss resulting not from the sale but from the guarantee contract with the bank. 8/5/94.

130.0098 **Cash Register Shortages.** Change error and theft or loss of moneys from the cash register are not allowable as adjustments to cash register sales. These errors in change, theft or loss or loss of moneys occurred after consideration for the merchandise had been recovered. 5/27/71; 5/20/96.

130.0099 **Charge Sales Checks.** The following are situations in which charge sales checks are considered to be bad debts under Regulation 1642:

(1) Charge sales checks having illegible or missing credit card imprints or handwritten customer names which are subsequently written off to cash register shortages.

(2) Charge sales checks which are lost prior to billing.

(3) Charge sales checks indicated by sales person as cash sales and therefore never billed to the customer. 5/27/71; 5/20/96.

130.0100 **Compromise Payment Made on Behalf of Debtor by Guarantor and Joint Venturer.** A corporation purchased tangible personal property on credit from a retailer, who reported sales tax measured by the full sales price of the property. The principal shareholders of the corporation executed a guaranty that the debt would be paid, in favor of the retailer, and the corporation executed an assignment of its share of profits which it expected to receive from a construction contract in which it had interest as a joint venturer with a second corporation.

When the retailer attempted to collect the amount of the debt, it was determined that the corporation and the guarantors were unable to pay, and that there were no profits forthcoming from the joint venture. However, the

guarantors and the second corporation offered to compromise the debt by payment of an amount equal to one-sixth of the original debt. Under such circumstances, the retailer was entitled to claim a bad debt loss for the difference between the amount of the original debt and the amount of the compromise payment made by the corporation's guarantors and joint venturer. 10/8/66.

130.0110 **Computing Bad Debt Loss—Alternative Methods.** Regulation 1642(f)(1) allows a person claiming a bad debt deduction or refund to use an alternative method (alternative to the methods contained in the regulation) of computing bad debt loss subject to approval by the Board. If the Board concludes that a proposed alternative method does not fairly compute the bad debt loss, the Board will deny use of the method and inform the person of the reasons for the denial. If the Board representative is unable to provide a reason for denying the alternative method, that would mean that there is no basis for denial, in which case the alternative method would be approved. 04/19/01.

130.0140 **Default on Accounts Receivable.** A carpet manufacturer sells carpet to a dealer on credit and advances cash to cover the dealer's ''profit, installation costs and sales tax.'' The dealer enters into a contract with a builder and agrees to furnish and install the carpet in a construction project. The dealer assigns the contract without recourse to the carpet manufacturer. Subsequently the builder defaults on the contract. Inasmuch as the dealer suffers no loss by reason of the builder's default, he has no basis for claiming a deduction for bad debts. 1/31/01. (Am. 2002–1).

(Note: Revenue and Taxation Code sections 6055 and 6203.5 were amended operative January 31, 2001, to allow a ''lender'' as defined to claim a bad debt deduction or refund under specified circumstances.)

130.0145 **Default on "No Recourse" Paper.** A retailer of sailboats sells to a bank chattel papers that the bank agrees to accept, without recourse. Although the bank establishes a Bankway Loss Reserve in the retailer's name and charges to the reserve any indebtedness or obligation of the taxpayer to the bank and any deficiency on any contract in default, the taxpayer is not entitled to any bad debt deduction for sales tax purposes on defaulted contracts because the paper was sold without recourse. The reserve functions as a kind of self-regulating discount provision and cannot be equated with a right of recourse. 11/3/72.

130.0160 **Foreclosure Proceedings.** Where a vendor forecloses for the amount advanced to a purchaser to enable him to buy a house which is relocated from its original site to another location, and the advance included sums to defray sales tax and complete the relocation, and a promissory note is taken for the advance which is secured by a deed of trust on the real property where the house is located, the vendor may take a bad debt deduction to the extent authorized by Regulation 1642. A returned merchandise credit is allowable only where the full sale price (including tax) has been refunded or credited. 10/25/60.

130.0180 **Franchise Tax Return.** A corporation is not entitled to a claim for refund for bad debts where the accounts were charged off on the personal income tax return filed by a stockholder and not on the franchise tax return of the corporation. 6/25/65.

BAD DEBTS (Contd.)

130.0200 **Illegal Diversion of Funds by Officer.** A corporation which suffers loss due to the diversion of funds by a corporate officer does not furnish a basis for a bad debt deduction for sales tax purposes. Bad debt deductions are allowable only with respect to debts arising from retail sales. 9/28/64.

130.0206 **Lease/Sale—Repossession and Subsequent Sale.** A firm "leases" equipment to a restaurant owner under terms which provide that ownership transfers to the lessee for $1.00 at the termination of the lease. The restaurant owner defaults on the lease, and the firm enters into a contract with the former owner of the restaurant to "assume the lease." The second contract contained the same provisions with respect to the transfer of ownership at the termination of the lease for $1.00 with a price adjustment due to the prior use of the equipment.

The original contract is a sale, and tax applies on the full contract price in the period in which the contract sale took place. The subsequent reacquisition by the seller because of default may result in bad debt deduction in accordance with Regulation 1642. The subsequent contract is also a sale at inception, and tax applies to the full contract price as provided in Regulation 1641. 4/16/97.

130.0212 **Photo Canvassing.** A photographic firm obtains orders for home portraits through canvassers. The photographs are taken by the firm's photographer. The proofs are returned to the canvassers who take them to the customers and attempt to obtain additional orders. When the canvassers obtain additional orders for prints, a down payment is made and the customers receive an invoice showing the total sales price, down payment and amount due. The prints are made up and mailed C.O.D. to the customers. Sometimes the customers refuse to accept the prints which are returned to the firm. In such cases, the firm does not return the down payment.

Under the circumstances, since the photographs have been made to the special order of the customers and the down payment was made, the sales were consummated. Therefore, the invoiced amounts are taxable gross receipts but the firm is entitled to a deduction for bad debts with respect to the unpaid balances. 11/10/65.

130.0215 **Property Subject to Foreclosure Sold by Debtor.** A taxpayer sold property on a conditional sale agreement. Tax was reported and paid on the sale. Subsequently, the buyer became unable to make payments. With the taxpayer's agreement, the buyer transferred the property to a new entity subject to the taxpayer's security interest. The sale by the buyer to the new entity was an exempt occasional sale. The new entity encountered financial difficulties and became delinquent in its payments to the taxpayer. The taxpayer repossessed the equipment.

The transfer from the buyer to the new entity did not change the status of the taxpayer as the retailer who paid the tax to the state on the original sales price. Accordingly, the taxpayer is entitled to claim a repossession loss in accordance with the regulation. 5/15/75.

130.0217 **Reconditioning Costs.** A corporation that sold mostly late model used cars operated used car lots. The corporation believes that reconditioning costs

should be added to the repossession losses in the computation of the bad debt allowance. The corporation based its belief on the "Information and Explanation" contained in the Kelly Blue Book which states ". . . . clean carefully reconditioned . . . ." The corporation also states that most of the repossessed cars have been poorly maintained as evidenced by the fact that substantial reconditioning costs were incurred on nearly all of them.

From the information furnished in the Kelly Blue Book, there seems to be no doubt that the amount stated therein is intended to represent the value of cars in better than average condition. It would also appear that all expenses incurred for necessary repair work and replacement of worn parts to fully recondition should be deducted from the Blue Book value to determine the actual wholesale value at the time of repossession. It is concluded that the Blue Book values should be reduced by the amounts of reconditioning expenses incurred which entail actual repair work and replacement of worn parts and accessories. No allowance should be made for charges such as "clean-up" expense or for other miscellaneous charges not involving repairs or reconditioning such as "speedometer set-back," fitting door keys, etc. If the clean-up charge entails washing, waxing, cleaning the motor, and a freshening up of the general appearance of the car, it does not appear to be allowable. While this might help promote the retail sale of the car, it would not appear to effect the wholesale value thereof. 9/22/66.

130.0220 **Repossessed Automobiles.** No additional credit for bad debts other than that based on the Kelly Blue Book values is allowed on repossessed automobiles which are reconditioned for resale, provided the automobiles are in average condition. However, an adjustment or additional allowance will be made to the published wholesale prices where the automobile is not in average condition and requires more than the normal get-ready or reconditioning to prepare the vehicle for resale. 12/9/66.

130.0225 **Repossession Loss.** A sold equipment to B, taking a down payment for one-third of the price and a promissory note for the balance secured by the equipment. B subsequently declared bankruptcy and the automatic stay prevented A from proceeding under the security agreement. A and B entered into a stipulation in the bankruptcy which provided that the stay would be lifted if the terms were violated. The terms were violated and A sold the equipment to C, applying the proceeds to the debt of B.

The sale of the equipment to C was not pursuant to the order of the bankruptcy court, nor was it made on behalf of the original buyer, B. The violation of the stipulation lifted the stay and allowed A to exercise its rights under the promissory note. The sale was made on A's own behalf.

Any bad debt loss to which A might be entitled on the sale to B is limited to the amount charged off for income tax purposes, and further limited by the repossession loss calculation pursuant to Regulation 1642(f). 4/6/90.

130.0240 **Rentals.** Lessors of tangible personal property who pay tax on rental receipts as they become due may properly deduct the amounts of such reported rentals as are found to be worthless and charged off for income tax purposes. 12/21/65.

BAD DEBTS (Contd.)

130.0250 **Statute of Limitations.** The statute of limitations on bad debts starts from the time in which the book entry is made, not the time in which the account was found to be worthless. Thus, a taxpayer may legally claim a bad debt deduction on a return filed within the three year statute of limitation period from the date of the book entry, i.e., if a book entry is made in the fourth quarter of 1973, the taxpayer would have until the fourth quarter of 1976 to file a claim for refund. 5/17/77; 8/1/77.

130.0260 **Successors.** A successor who pays full consideration for accounts receivable acquired from the predecessor is entitled to take a bad debt deduction on account sales made by a predecessor, provided all other conditions for taking the deduction are complied with. 9/30/59.

130.0269 **Third Party Credit Card Sales.** Company A enters into contracts with a retailer, whereby Company A issues credit cards to the retailer's customers. Under the terms of the credit card agreement, the cardholders remit their payments to Company A. Pursuant to the contract with the retailer, Company A remits to the retailer, at a discounted rate, the purchase price including sales tax, on purchases made by the credit card holder. Company A takes full responsibility for collection and, if the account becomes uncollectable, Company A takes the federal income tax "write-off" for bad debts.

The discount rate paid to the retailer is negotiated annually by balancing anticipated revenues against expenses. An important factor in calculating the discount rate is the magnitude of accounts that have become uncollectable.

The retailer is liable for sales tax on its sales. Under section 6055 and Regulation 1642(h)(1), the retailer is not entitled to the worthless account deduction for accounts found to be worthless since it is not claiming the bad debt loss for federal income tax purposes. Company A is not entitled to a bad debt deduction because it was not the retailer of the property and owed no sales tax against which to take the bad debt deduction. 12/4/95.

130.0280 **Worthless Check.** A loss attributable to a worthless check cashed for a sum in excess of the amount of the taxable sale is not allowable as a bad debt deduction to the extent of the excess. 12/29/59.

BANKRUPTCY

Trustees in, sales by, see Court Ordered Sales, Foreclosures and Repossessions. Postbankruptcy interest and penalties, see Interest and Penalties.

135.0000 BANKS AND INSURANCE COMPANIES—Regulation 1567

135.0005 **American Express Company.** The American Express Company does not qualify as a bank since it has not been chartered as a banking institution under state or federal law.

The fact that it performs some functions normally performed by banks, and is classified as a "financial institution" for franchise tax purposes, is insufficient to warrant classification of the entity as a bank for sales and use tax purposes. 3/30/78.

BANKS AND INSURANCE COMPANIES (Contd.)

135.0010 **Attorney-in-Fact of Reciprocal or Interinsurance Exchange.** A corporate attorney-in-fact of a reciprocal or interinsurance exchange is exempt from payment of the use tax on property used exclusively in its insurance operations. 1/16/74, 1/30/74.

135.0030 **Bank Credit Bids to Acquire Property.** A bank holds a perfected security interest in tangible personal property. Rather than repossessing the property, the bank holds an auction and as a creditor bids-in and acquires the property. The sale to the bank as a purchaser (other than a federally chartered bank exempt from direct taxation) is subject to tax unless the bank establishes that the property was purchased for resale. 9/29/88.

135.0065 **Checks Sold by a Federal Credit Union.** A military federal credit union, with a main office in this state, operates branches throughout the Far East. The branches use an APO San Francisco, 96343 as an address. Any organization/individual using this address is not physically located in California.

It is assumed that the federal credit union is the retailer of the checks. As a matter of state law, the incidence of sales tax is on the retailer. Since a federal credit union is exempt from sales tax, the retail sales of checks in California by the federal credit union are also exempt from sales tax. Since the federal credit union's sales are exempt from sales tax, use tax applies when the checks are purchased for use in California, and when the use tax applies, the federal credit union is required to collect that use tax from its customers and remit the tax collected to the state. It is presumed that mail addressed to an APO is forwarded outside California. This means that checks mailed to a customer through an APO address are presumed to be purchased for use outside California and not subject to use tax. Records showing names and addresses as they appear on the mailed matter must be kept as evidence of the mailing. 12/18/86; 3/2/88.

135.0080 **Collection of Use Tax by Banks.** In the following transactions involving the sale of tangible personal property:

1. The borrower sells his equity in property, which has been mortgaged or pledged to the Bank as security for a loan, to a third party who assumes the unpaid balance of the obligation to the Bank.

2. The borrower sells the mortgaged or pledged property to a third party subject to the mortgage or pledge and the Bank releases its claim under the mortgage or pledge upon receipt of payment of the obligation to it.

3. Same as 2 except that the Bank finds the purchaser and the sale from the borrower to the purchaser is handled by a Bank officer.

4. The borrower delivers the mortgaged property to the Bank and consents to its sale. The Bank then sells the property to a third party, applies the proceeds to the debt and delivers the balance, if any, to the borrower.

5. The Bank holds a pledgee sale, after legal notice, and sells the pledged property to a third party at such sale. The proceeds are applied to the debt and the balance, if any, is delivered to the borrower.

BANKS AND INSURANCE COMPANIES (Contd.)

6. The mortgaged property is sold to a third party at a sale conducted by a Court officer in a foreclosing proceeding and the proceeds are delivered to the Bank in payment of the debt.

7. The borrower delivers property to the Bank upon which the Bank has no lien and requests the Bank to sell the property for him and apply the proceeds on the debt. The Bank then sells the property to a third party, as agent for the borrower who is the owner of the property and applies the proceeds on the debt.

The Bank is liable for the collection of the use tax from customers in transactions numbered 4, 5, and 7. In each of these transactions the Bank appears to be the seller. In transaction number 6 the sale is by a court officer and in cases 1, 2, and 3, the original owner (borrower) is the seller. He is liable for the tax if he qualifies as a seller or retailer under the terms of the Sales and Use Tax Law. Although in case number 3 the Bank finds the purchaser, it appears that the borrower actually makes the sale in the sense that he has, and exercises, the power by his own act to transfer beneficial title to the purchaser. 2/21/56.

135.0100 **Federal Savings and Loan Associations.** Federal Savings and Loan Associations are not "Banks." 1/12/50.

135.0130 **Imposition of Sales and Use Taxes on Banks.** Under Statutes 1979, Chapter 1150 (AB 66) sales and use taxes are imposed upon banks with respect to all income years, as defined in Revenue and Taxation Code Section 23042, beginning on and after January 1, 1980. Accordingly, if a bank's income year begins January 1, 1980, it is subject to sales and use taxes January 1, 1980. If its income year begins July 1, 1980, it is subject to sales and use taxes July 1, 1980.

Section 6051 imposes the sales tax upon the gross receipts from the sale of tangible personal property in this state. Commencing with the first day of the bank's fiscal year beginning on and after January 1, 1980, retail sales by banks that are retailers (as defined in Sections 6015 and 6019) are subject to the sales tax unless otherwise exempt. For purposes of the sales tax the taxable event is the sale (as defined in Section 6006) in this state.

Section 6201 imposes the use tax on the storage, use, or other consumption in this state of tangible personal property purchased from a retailer. The taxable event is the first storage or use of the property in California. If that occurs after the bank becomes subject to use tax, then the use tax applies.

In some instances, such as when the property is in transit to the bank, it may be difficult or impossible to determine when that first use in California occurs and whether the use is before or after the bank becomes subject to the use tax. For this reason we shall consider that the use tax does not apply if, prior to the time the bank becomes subject to use tax, the property is shipped from an out-of-state supplier directly to and consigned to the bank in interstate commerce with title to the property passing to the bank upon delivery by the supplier to the carrier at the out-of-state point. Also the use tax does not apply if the property is received by and stored, used, or otherwise consumed by the bank prior to the time the bank becomes subject to the use tax. 12/5/79.

BANKS AND INSURANCE COMPANIES (Contd.)

135.0140 **Independent Insurance Agents and Adjusters—Use Tax.** Article XIII, Section 14⅘ of the California Constitution imposes a tax upon each insurer doing business in this state which is in lieu of all other taxes, with certain exceptions. This article does not exempt independent insurance adjusters or independent agents, who purchase tangible personal property for use in their business, from the use tax. 6/21/67.

135.0160 **Insurance Company's Sales.** Where an out-of-state insurance company makes sales to persons other than its agents, for instance, brokers, or to its agents of tangible personal property not connected with the insurance business, it is required to collect the use tax and register with the board. 11/17/66.

135.0170 **Joint Venture.** A joint venture was created consisting of insurers registered to do business in California and paying the California gross premiums insurance tax. The in-lieu provision of the insurance tax would not apply to this joint venture unless the joint venture independently qualifies as an insurer paying the California gross premiums insurance tax. The exemption from tax covered in Regulation 1567(b) would not be applicable to this joint venture. 1/10/92.

135.0176 **Leases by Insurance Company to Independent Agents.** Use tax applies to rental receipts received by an insurance company on rental of computer equipment to its independent agents. Although the agents sell the company's insurance only, they are not the insurance company's employees but rather independent operators who are paid on a commission basis and who operate out of their own offices. Under such circumstances, the imposition of use tax upon these agents based on rental receipts has an impact on the insurance company which is at most minimal and indirect. A tax imposed on insurance agents is constitutionally and statutorily prohibited only where it directly affects the insurance company. 7/15/83.

135.0180 **Leases of Personal Property.** Banks and insurance companies that acquire tangible personal property ex tax and lease the property are required to collect the use tax measured by the rental receipts from such leases. 8/11/65.

135.0221 **Leases of Personal Property.** Banks are authorized to purchase tangible personal property under resale certificates which they will lease to customers under a lease providing that the property remains tangible personal property even though it may be affixed to real property.

(Note: Effective December 16, 1971, the term ''tangible personal property'' as defined by Revenue and Taxation Code Section 6016.3 includes only leased ''fixtures'' as to which the lessor has the specified right of removal. Property which constitutes ''materials'' under Regulation 1521, such as wall-to-wall carpeting, is not classified as tangible personal property even where the lessor has the right of removal upon breach or termination of the lease. Accordingly, banks may not issue resale certificates for materials. Persons who furnish and install materials are consumers of the materials, and tax applies to the sale of the property to them.) 1/23/76.

BANKS AND INSURANCE COMPANIES (Contd.)

135.0225 **Lease Payments by Insurance Companies.** Insurance companies that pay lessors for medical equipment leased by a covered patient are not lessees of the property. The lease contract is with the patient and the applicable tax is a use tax imposed on the patient/lessee. If an insurance company is a lessee, the applicable tax is the sales tax since the use tax can not be imposed on an insurance company. 12/18/92.

135.0271 **Nonprofit Hospital Service Corporation.** Even though a hospital is licensed by the Department of Insurance as a nonprofit hospital service corporation pursuant to Division 2, Part 1, Chapter 11A of the Insurance Code (Insurance § 11491 et seq.), it is not an insurer within the meaning of California Constitution Article XIII, section 28, and it is not required to pay gross premium tax on insurers. Under Chapter 11A, nonprofit hospital service corporations are declared to be charitable and benevolent institutions rather than insurers. Accordingly, such hospital is not exempt from use tax as an insurer. 9/11/87.

135.0272 **Nonprofit Hospital Service Corporations.** A nonprofit health service provider believes that it is a nonprofit hospital service corporation. It is regulated by the Department of Insurance, collects premiums, pays claims and is allowed by the Internal Revenue Service to deduct ''claims reserves'' on its federal income tax returns. As such, it believes that it is exempt from use tax under Insurance Code section 11493.5. The provider does not believe that it is an insurance company. The provider is not an insurer which files tax returns with the Insurance Commissioner or pays a gross premium tax.

The courts have held that Section 11493.5 only exempts hospital service corporations from a property tax on their funds. (*Hospital Service of California* v. *City of Oakland* (1972) 25 Cal.App.3d 402.) It does not exempt these corporations from excise taxes such as the use tax. By purchasing tangible personal property for use in this state and using it here, the health service provider has subjected itself to the use tax. 8/29/90.

135.0275 **Nonprofit Hospital Service Plan.** A nonprofit hospital service plan is not an ''insurer'' as defined by Article XIII, Section 28 of the California Constitution. Thus, they are subject to use tax in California. 4/18/89.

135.0300 **Occasional Sales.** The purchase of data processing equipment from an insurance company not required to hold a seller's permit is not exempt as an occasional sale under Sections 6367 and 6006(a) of the Revenue and Taxation Code since the equipment was held and used by the insurance company in the course of an activity for which the company would have been, but for the provisions of California Constitution, Article XIII, Section 14 4/5(f), required to hold such a permit. To interpret Section 6006(a) in any other manner would be to defeat the statutory scheme of taxation sanctioned by the California courts in *Beneficial Standard Life Insurance Co.* v. *State Board of Equalization,* 199 Cal.App.2d 18. 6/3/69.

135.0310 **Occasional Sales—Insurance Company.** The sale of a pre-written computer program, originally developed by an insurance holding company for its own use, does not qualify for the sales tax exemption as a sale by an insurance

company since a holding company does not pay the ''in lieu'' gross premiums tax. The sale may, however, be exempt as an ''occasional sale'' if the seller has not made three or more sales of substantial amounts or a substantial number of sales in small amounts in a twelve month period. In determining if this test is met, all sales of tangible personal property must be considered, including sales to related or subsidiary companies. If this sale does not meet the ''number of sales'' test, it is still possible that tax might apply if the holding company is actively seeking to promote additional sales of the program. This promotion would make the holding company a ''seller'' pursuant to section 6014 of the Revenue and Taxation Code and preclude the Occasional Sale exemption. 9/22/93.

135.0322 **Person—State-Chartered Credit Unions.** Sales by other states and their political subdivisions are not subject to sales or use tax because such entities are not included in the section 6005 definition of ''person.'' However, credit unions chartered by other states are not instrumentalities of those states. They are persons that could be sellers and therefore retailers if they make retail sales of tangible personal property to consumers in this state. Credit unions chartered by this state are also persons whose retail sales are subject to tax. 12/14/94.

135.0350 **Sales to Insurance Companies.** The California Supreme Court has overruled a previous court decision and held that the ''in lieu'' provision of Section 28(f) of Article XIII of the California Constitution (which provides that the gross premiums tax on insurance companies is in lieu of all other taxes) applies to all activities of an insurance company, (*Mutual Life Ins. Co. of New York* v. *City of Los Angeles* (1990) 50 Cal.3d 402.).

However, this decision does not apply to sales which are made to an insurance company by a retailer located within California. The sales tax is a tax on the retailer, not on the purchaser, even if the retailer collects sales tax reimbursement from the purchaser. Therefore, an insurance company is not paying a tax when it pays sales tax reimbursement to the retailer, and the ''in lieu'' provisions considered in the above court case do not apply. 6/12/90.

135.0355 **Sales to Insurance Company** An out-of-state taxpayer with sales offices and warehousing in California sells labels to an insurance company located in California. The insurance company contacts the taxpayer's sales office in this state to order labels. The taxpayer's employee takes the order and arranges for the manufacture and delivery of these labels. The labels are manufactured out of state and then shipped by common carrier directly to the insurance company in California. The contract of sale is silent as to the passage of title.

Under these circumstances, since the contract of sale is silent as to passage of title, title passes from the seller, and thus the sale occurs no later than the time at which the seller completes its performance with respect to the physical delivery of the property. This generally occurs upon the seller's delivery of the property to a common carrier for shipment to the customer. Accordingly, because the sale takes place outside of California, the applicable tax would be use tax imposed on the insurance company rather than sales tax imposed on the retailer. If the insurance company is paying the California Insurance Gross Premiums Tax, its

BANKS AND INSURANCE COMPANIES (Contd.)

use of the labels is exempt from California use tax under Section 28 of Article XIII of the California Constitution. 3/27/97.

135.0370 **Shipment from Point Inside California.** An insurance company includes a stamp on purchase orders specifying that title to merchandise purchased passes upon delivery by the seller to a common carrier outside California. For goods shipped from points outside California, sales tax does not apply to the sale. Since insurance companies are exempt from use tax, no tax applies to transactions of this type. However, if the goods are shipped from the vendor's location inside California, the stamp is ineffective. A seller could not accept an exemption claim of this type in good faith. Therefore, the applicable tax is the sales tax, which is the liability of the seller. The seller may bill the insurance company for sales tax reimbursement if the contract so provides. 8/23/88.

135.0600 **Treaty Immunizing Bank from Tax.** The terms of a treaty immunized the operations of the NAD Bank (established by the governments of the United States and Mexico to finance environmental infrastructure projects in the U.S.-Mexico border region) from tax and also immunized it from tax collection duties. In addition, the terms of the treaty were specifically made part of the law of the land by Congress. Section 6352 exempts from sales and use taxes the gross receipts from the sale of and the storage, use, or other consumption in this state of tangible personal property the gross receipts from the sale of which, or the storage, use, or other consumption of which, this state is prohibited from taxing under the Constitution or laws of the United States or under the California Constitution. When the United States enters into a treaty with another country, its provisions become part of the laws of the United States. Thus, if such a treaty prohibits the states from imposing certain taxes, this state is prohibited from imposing such taxes. The treaty must, however, grant immunity from the particular tax at issue. For example, a treaty giving immunity from taxes on property does not provide immunity from excise taxes.

Here, the treaty provided the bank immunity from all taxation and tax collection duties. Thus, under section 6352, sales of tangible personal property by or to the bank are not subject to tax. Consequently, when purchasing from California retailers, the bank may issue exemption certificates conforming to the requirements of Regulation 1667. Although the bank is not subject to the duty to collect use tax on any of its sales of tangible personal property to California residents which are not subject to sales tax, the use tax still applies to such sales, and the purchasers must self-report their liability. 12/21/95.

BARBERS
See Miscellaneous Service Enterprises.

140.0000 BARTER, EXCHANGE, "TRADE-INS"—Regulation 1654
See also Gross Receipts.

140.0003 **Barter, Exchange, etc.—Tangible for Intangible.** A TV manufacturer provides a new TV set to a television network for use as a prize on a game show ". . . in exchange for an identification." The agreement between

the parties specifies that if conditions prevent the network from giving the contracted identification, they will pay for the TV set ". . . at dealers' cost." This establishes the gross receipts from the exchange of the TV set, which is a taxable sale by the manufacturer in spite of the fact that the consideration normally received is intangible air time.

In the absence of wording in the agreement implying or specifying the value of the property or air time being exchanged, the suggested retail price of the property contained in the agreement would be the measure of tax. 8/22/78.

140.0004 **Barter or Trade for Silver Coins.** A gasoline retailer advertised the sale of gasoline for one silver U.S. dime. He also offered to sell gasoline for the posted prevailing price which is in excess of $1.00 a gallon without mentioning any particular form of payment. The silver dimes, although legal tender, are not being traded at minted face value but rather at their precious metal or numismatic value. Considering the difficulty of placing a daily value on a fluctuating commodity, it may be assumed that the value of a silver dime is equal to the amount of the posted price of the gasoline acquired in exchange for it. 2/14/80.

140.0005 **Equipment Exchange.** A firm manufactures and sells fault tolerant large mainframe computer systems and fairly large minicomputer systems. The firm also helps its customers relocate their data centers. The firm is considering offering an option whereby the firm would place its reconditioned equipment at the new location. Once the system at the new location is functional and the application programs have been transferred, the customer's equipment at the old location would be removed and returned to the manufacturer. The equipment swapped would be unit-for-unit, of equivalent condition.

The transaction would result in the manufacturer making a retail sale of equipment to the customer with the manufacturer taking the customer's equipment as a trade-in. The gross receipts of the sale include the fair market value of the equipment traded in and any other consideration paid by the customer for the swap. Charges for labor for services used in installing the equipment sold would be excluded from the measure of tax. 2/18/93.

140.0007 **Exchange Value.** Internal Revenue Code section 1031 provides that no gain or loss shall be recognized on the exchange of property held for productive use in trade or business or for investment if such property is exchanged solely for property of like kind which is to be held for productive use in a trade or business or for investment. An exchange of property transferred pursuant to Internal Revenue Code section 1031 is a sale pursuant to Sales and Use Tax Law section 6006(a), and the measure of tax is the realistic exchange value as negotiated by the parties in an arms length transaction. 12/16/91.

140.0010 **Gross Receipts for Exchange Transactions.** In the case of an exchange, gross receipts includes the value of the property received and all directs costs, such as freight, inspection fees, import fees, broker fees, taxes, etc. or any other fees, associated with the property received in the exchange. 6/22/78.

BARTER, EXCHANGE, ETC. (Contd.)

140.0020 **Overallowances.** Although a discount is not a part of taxable gross receipts, an amount designated as an ''overallowance'' on merchandise traded in may not be excluded upon the ground that it is a discount. 11/27/51.

140.0023 **Platinum Used by Oil Refiners.** The application of the tax to certain transactions involving transfers of both spent and fresh platinum catalysts between fresh catalysts manufacturers (the manufacturer) and oil companies (the refiner) who use the catalysts in the refining process follows. These transactions can occur in four basic variations:

(1) Fabrication. A refiner sends spent catalysts to the manufacturer who salvages the platinum component from the spent catalyst and fabricates fresh catalyst using the salvaged component. By agreement, title to the platinum remains in the refiner. The fresh catalyst containing the consumer-furnished component is then sent to the refiner. The manufacturer charges the refiner for salvaging the platinum component of the spent catalyst and for fabricating the fresh catalyst.

The correct measure of tax is the amount charged to the refiner by the manufacturer, i.e., the salvage charge and the fabrication charge. Tax would not apply to the value of the platinum component returned by the manufacturer to the refiner because the refiner would receive from the manufacturer, as part of the fresh catalyst, the same platinum furnished by the refiner to the manufacturer as a component part of the spent catalyst. Title to the identifiable platinum would at all times remain in the refiner.

(2) Sale-Exchange. A refiner sends a spent catalyst to the manufacturer. Following receipt of the spent catalyst but before the salvaged free platinum furnished by the refiner has been fabricated into fresh catalyst, the manufacturer sends fresh catalyst to the refiner. The exchange may take place at the moment that the manufacturer receives the spent catalyst sent by the refiner or at any moment before the manufacturer has on hand fresh catalyst produced from free platinum furnished by the refiner. The parties may or may not purport to agree that title to the platinum furnished by the refiner remains in the refiner. The manufacturer charges the refiner for salvaging the platinum component and for ''fabricating'' the fresh catalyst, but does not charge the refiner for the ''trade-in'' value of the platinum component.

The measure of tax should properly include the ''trade-in'' value of the platinum component. The refiner would not have furnished either directly or indirectly the material used in the producing or fabricating of the fresh catalyst.

(3) Fabrication—Commingling. A refiner sends a spent catalyst to the manufacturer who may commingle the spent catalyst with catalyst furnished by another refiner. The manufacturer salvages the platinum component from the spent catalyst and may commingle the platinum component (free platinum) with the platinum component salvaged from spent catalyst furnished by other refiners. The manufacturer fabricates fresh catalyst using this salvaged component and commingles the fresh catalyst with fresh catalyst fabricated by the manufacturer from the salvaged component of spent catalyst furnished by other refiners. By agreement between the refiner and the manufacturer, title to the platinum remains

in the refiner. The fresh catalyst containing (perhaps) the consumer-furnished component is then sent to the refiner. The manufacturer charges the refiner for salvaging the platinum component of the spent catalyst and for fabricating the fresh catalyst but does not charge the refiner for the ''trade-in'' value of the platinum component.

Tax applies only to the fabrication charge. The refiner should not be regarded as trading in the platinum component of the spent catalyst merely because the spent catalyst or the free platinum or the fresh catalyst happen to be fungible goods and the catalyst manufacturer chooses, as its business practice, to commingle these fungible goods with other goods belonging to other persons. The refiner would bear the tax burden assessed against the manufacturer merely because the manufacturer did not segregate the consumer-furnished material in its possession.

(4)(a) Sale—Commingling—Exchange. Same as (3); however, the manufacturer sends fresh catalyst to the refiner sometimes following receipts of the spent catalyst but before salvaged free platinum furnished by the refiner has been fabricated into fresh catalyst. The exchange may take place at the moment that the manufacturer receives the spent catalyst or at any moment before the manufacturer has on hand fresh catalyst produced from salvaged free platinum furnished by the refiner. The billing is the same as in (3).

(4)(b) Sale—Commingling—Exchange (Deficit Memo). Same as (3); however, the manufacturer sends to the refiner fresh catalyst sometimes before the refiner sends any spent catalyst to the manufacturer. The manufacturer ''debits'' the refiner's ''platinum account'' and bills the refiner as in (2). When the refiner subsequently furnishes spent catalyst to the manufacturer, the manufacturer ''credits'' the refiner account, thus completing the transaction. This has been called the ''deficit memo'' case. The billing is the same as in (3).

Tax applies only to putative fabrication charge. Where on an exchange basis there is a breaking down of a ''spent'' item of tangible personal property into raw materials and the fabrication of the raw materials into a ''fresh'' item of property, the transaction is regarded as a fabrication, not a repair transaction (even though the transaction is not a fabrication transaction but an exchange transaction). The transaction is then taxed in the same manner as a repair transaction. Since the ''commingling'' principle in the fabrication context is applied, it would seem somewhat artificial to require the seller to delay shipment of the ''fresh'' item until such time as (a) he had manufactured, from the consumer-furnished raw material, an amount of the ''fresh'' item equivalent to the amount to be shipped, or (b) the raw components have otherwise ''crossed.'' The continued reimposition of the tax could be avoided if the refiner maintained a double supply of the raw materials, the amount of the raw material which the refiner is consuming in an economic sense. Tax does not apply to the value of the raw component exchanged for the fabricated product, even where the transaction is on a ''deficit memo'' basis, at least where the transaction resembles a repair transaction.

BARTER, EXCHANGE, ETC. (Contd.)

There was an additional question concerning the application of tax to certain ''turnaround'' and lease charges made by the manufacturer to the refiner. The standard agreement used by a manufacturer provides that the manufacturer will sell to the refiner ''quantities of catalyst equivalent to one normal loading of catalyst'' for each of the refiner's refining units. The catalyst is to be produced from refiner-furnished platinum. The price of the catalyst to the refiner does not include the value of refiner-furnished platinum component. Thereafter, the refiner will return the used catalyst to the manufacturer for recovery of the platinum from the used catalyst. The manufacturer will make a ''recovery charge'' for the salvaging operation and the recovered platinum will then be processed into fresh catalyst. The price of the fresh catalyst would again exclude the value of the refiner-furnished platinum. The manufacturer agrees to maintain for the refiner a ''platinum stock account'' to record the quantities of all platinum received from and shipped to the refiner.

These transactions should be regarded as true lease transactions and not sales at their inception, even though the property is in fact always sold to the lessee. The rent paid under this agreement is based upon prevailing interest rates on the date the platinum is furnished to the refiner. Because the price which the refiner will be paying for the leased platinum is the market price on the date the platinum is ''returned,'' and not the market price on the date the platinum is first furnished by the refiner to the manufacturer, it does not appear that the rental charges are mere finance charges. If the ''price'' of the platinum were the market price on the day the platinum was furnished to the refiner, then a ''rent'' based on current interest rates would appear to be a finance charge. It also appears that the ''rental'' payment is a payment for the use of the platinum, not the capital tied up in the platinum, even though the rental payment is based upon the prevailing interest rate.

The following applies to the ''oil refinery noble metal catalyst:''

(1) Does the repair—reconditioner rule of Regulation 1546 apply to these exchange transactions?

No.

(2) Is there one commingled mass of fungible goods (the material in the hands of the manufacturer) or four commingled masses (spent catalyst, free platinum, catalyst in process, fresh catalyst)?

There is, in effect, one mass. The lesser measure of tax is allowed even where it is certain that the consumer receives only tangible personal property which does not and never has belonged to him.

(3) Are these lease transactions or are they sales at their inception?

They are lease transactions. 8/26/70.

140.0026 **Rebate from Manufacturer—Trade-In.** A retailer purchases a product from a distributor for $29,000 for resale and sells it to a customer for $28,000 less a cash discount of $2,800 for a net sale price of $25,200. The retailer

charges sales tax to customer based upon the net sales price of $25,200. The customer's old product, which is taken by the retailer upon the sale of the new product to the customer, is sent to the manufacturer for a rebate of $5,000 to the retailer.

In this transaction, the customer has contracted to pay a certain sum of money plus transfer the old product as consideration for acquiring the new product. Taxable gross receipts from this sale includes the fair market value of the old product, which is $5,000. That amount must be included in the retailer's taxable gross receipts. Thus, the correct measure of tax is $30,200; $25,200 cash price plus $5,000 trade-in. 9/20/94.

140.0028 **Replacement Not Treated as Trade-In Merchandise.** A retailer of motion picture films informed his customers through its price lists that an old or damaged print could be replaced with a new print of the same subject at a 20% replacement discount provided the old or damaged print was returned to the retailer for destruction. When a customer took advantage of this offer, the retailer's billing to the customers showed the list price of the print, the replacement discount, and a net price upon which tax reimbursement was computed. The old or damaged print returned, being of no value to the retailer, was destroyed and discarded. The transaction under the above circumstance did not involve merchandise traded-in as set forth in Regulation 1654(b)(1) and, therefore, the replacement discounts are not includable in gross receipts. 9/28/71.

140.0040 **Trade-Ins.** Where a retailer advertises that he will sell a new tire for a certain price plus an old tire, the trade-in allowance of the old tire must be established and included in taxable gross receipts. Even if the retailer contends that the trade-in allowance is greater than the value of the item traded in, the trade-in allowance is the amount included in gross receipts for purposes of measuring sales tax.

The trade-in allowance is the difference between the amount charged customers leaving their worn tire and the amount charged other customers, at a similar time, who do not exchange an old tire. For example: Usual price without exchange is $16.00. Advertised sale price where old tire is traded in is $14.00. The taxable trade-in allowance of the old tire is $2.00. 9/11/53; 2/6/91.

140.0050 **Trade-In of Software.** A retailer offers a promotional discount/trade-in whereby the customer was forced to give up his current software in order to obtain the company's so-called promotional discount. An agreed value between buyer and seller was reached as to the value of the traded in software.

When a retailer accepts a trade-in, the retailer must include in the measure of tax the amount agreed upon between the retailer and the buyer as the allowance for the merchandise traded in. If there is a trade-in and also a discount, the contract between the seller and the buyer must make it clear that the parties contract for both a trade-in allowance and for a discount. 12/14/92.

BARTER, EXCHANGE, ETC. (Contd.)

140.0080 **Trade-In Value.** Where the parties have not fixed a trade-in value on worn property and where the worn property has no scrap value and is junked at the time of trade-in, the worn property has no market value to be added to the selling price of the item upon which it was traded-in. 1/26/68.

140.0100 **Trade-Ins—Underallowance.** When a used automobile is traded in on the purchase price of a new automobile, the dealer accepting the trade-in must include in the measure of tax the amount agreed upon between the seller and the buyer as the allowance for the merchandise traded in. However, if the allowance stated in the agreement is less than the fair market value, the stated value will not be accepted if there is sufficient evidence to establish that the underallowance on a trade-in was not the result of a bona fide transaction between the seller and the buyer, that is, the dealer deliberately lowered the trade-in value of an automobile to reduce the measure of tax. A dealer's intent to evade paying the proper amount of tax due may be evidenced by, among other things, recorded trade-in allowances that are consistently below market value and which are not attributed to trade in automobiles that are in less than fair condition; gross profit margins that are consistently lower on transactions involving trade-ins than on transactions without trade-ins and which are not attributed to business practices pursued by the industry, such as trades on loss-leader automobiles, or trades during promotional sales; and a widespread pattern of underallowances occurring consistently throughout the audit period. If an underallowance is an isolated transaction, the Board would examine whether the difference in the trade-in value and the fair market value listed in the Kelley Blue Book is attributable to the condition of the particular automobile. Where an underallowance is not a bona fide transaction, the Board would tax the underallowance as additional gross receipts and consider whether a 25 percent intent to evade penalty should be imposed. 6/26/96.

140.0500 **Underallowance on Trade-Ins—Automobiles.** When a used automobile is traded in on the purchase price of a new automobile, the dealer accepting the trade-in must include in the measure of tax the amount agreed upon between the seller and the buyer as the allowance for the automobile traded in. (Regulation 1654(b)(1).) If an underallowance on a trade-in is the result of a bonafide transaction between the seller and the buyer, additional tax should not be computed on the underallowance for the same reason that the Board does not redetermine the fair market value of a trade-in when the agreed upon price is above the price listed in the Kelly Blue Book. Instead, the agreed upon trade-in value is included in the measure of tax from the sale of the automobile.

Regulation 1654(b)(1) also provides that should the Board find that the allowance stated in the agreement is less than the fair market value, it shall be presumed that the allowance actually agreed upon is such market value. However, if there is sufficient evidence to establish that the dealer deliberately underallowed the trade-in value to reduce the measure of tax, the underallowance is additional gross receipts. If this is the case, an intent to evade penalty would also be imposed. In summary, the underallowance is part of gross receipts when a transaction is structured to evade tax and not simply because the dealer has negotiated a favorable contract. 12/21/95.

BEAUTY SHOP OPERATORS
See Miscellaneous Service Enterprises.

145.0000 BEER, WINE AND LIQUOR DEALERS—Regulation 1568

BOARDING HOUSES
See Taxable Sales of Food Products.

BOOKBINDERS
See Miscellaneous Repair Operations.

BOOTBLACKS
See Miscellaneous Service Enterprises.

BROKERS
See Consignees and Lienors of Tangible Personal Property for Sale.

150.0000 BUILDINGS AND OTHER PROPERTY AFFIXED TO REALTY—Regulation 1596
See also Construction Contractors.

150.0020 **Appliances Sold with Realty.** A refrigerator, gas range and washing machine sold with a house by a contractor are subject to tax measured by the contractor's gross receipts from the sale of the appliances. It is immaterial that the cost of the appliances is included in the real estate mortgage, that the appliances are installed before the buyer receives the beneficial title to the property, that the appliances are firmly attached to the realty by gas pipes or rubber water connections or that the spaces between cabinets are specifically designed to accommodate the particular appliances. 7/10/58.

150.0060 **Buildings—to be Removed by Purchaser.** A sale of a building affixed to land owned by the seller is not a sale of tangible personal property even though the purchaser is to remove the building after the sale. If the seller is to remove the building, however, the sale is a sale of tangible personal property. Opinion of the Attorney General No. 67/218; 9/6/68; 9/12/68.

150.0080 **Cabinets, etc.** Cabinets prefabricated by a contractor are sold as a part of the realty if installed in his house constructed by him on his lot prior to sale. However, if the contractor installs such prefabricated cabinets in a house which he has agreed to construct on a lot sold by him, the cabinets are sold as a part of the realty only if the purchaser does not have legal or equitable title to the lot at the time of the installation. If pursuant to an agreement to sell a house the contractor includes a refrigerator, stove, washer or other equipment not built-in the sales tax applies to the fair retail sale price of the equipment. 7/15/57.

150.0100 **Christmas Trees.** A retail sale of tangible personal property occurs when an owner or operator of a Christmas tree farm allows a consumer to come onto the farm and, for a price, to cut and remove Christmas trees. This is in accord with the California Commercial Code Section 2107(2) which provides:

"A contract for the sale apart from the land of growing crops or other things attached to realty and capable of severance without material harm thereto but not described in subdivision (1) [minerals or a structure] or of timber to be cut is a

contract for the sale of goods within this division whether the subject matter is to be severed by the buyer or by the seller even though it forms part of the realty at this time of contracting, and the parties can by identification effect a present sale before severance.'' 11/22/65.

150.0125 **Draperies Sold with Residence.** A retailer sells and installs draperies to a construction contractor who will resell the draperies together with the home. The drapery retailer is making a retail sale of the draperies. Since the sale of the draperies in place by the contractor is not a sale of tangible personal property under Regulation 1596, removal of the draperies is not contemplated by either the seller (contractor) or the buyer. 4/13/81; 7/10/96.

150.0140 **Earth—Severance.** The sale of earth is not taxable when a landowner gives permission to have the earth removed from his land, in which case the earth becomes personal property by the act of severance performed by the purchaser. 8/18/64.

150.0160 **Electrical Appliances.** Electrical appliances such as a range and refrigerator installed in a house do not become a part of the realty but retain the character of personalty. Accordingly, upon a sale of the house, including the range and refrigerator, the sales tax applies to the sale of such personalty, irrespective of whether the sales price of the range and refrigerator are separately stated. 8/26/53.

150.0180 **Electrical Systems.** The sales by a power company of two ''electric systems,'' including transmission lines, substations, distribution lines, service lines, and meters constitute sales of real property to which the sales tax does not apply. The transmission and distribution lines are exempt by virtue of Section 6016.5, and such items as pole transformers and residence meters which are attached to the realty and become an integral part of the transmission and distribution system cannot be segregated and treated as tangible personal property. 6/24/69.

150.0200 **Fall-Out Shelters.** Sales of fabricated steel shelters to persons who install them are retail sales and taxable as such. 11/22/61.

150.0220 **Fixtures Included in the Sale of a Business.** When the sale of a business includes buildings and land the following items are part of the realty, if attached:

(1) Planers and molding machines which are heavy equipment used in a sawmill,

(2) Carriage and circular saw, used in a sawmill for the first cutting of the logs,

(3) Compressor and heavy duty electric motor used in a grocery store in connection with a walk-in beer cooler,

(4) Service station hydraulic hoist. A small one-half horsepower bench grinder is considered as tangible personal property. 9/10/57.

BUILDINGS, ETC. (Contd.)

150.0260 **Furnished Apartment Houses.** The sale of a furnished apartment house involves the sale of tangible personal property subject to sales tax. What constitutes personalty rather than realty with respect to the usual items in such a transaction is summarized below:

Curtain rods, drapery rods, venetian blinds, and window shades are regarded as part of the realty.

Attached wall beds are realty.

Wall-to-wall carpeting and pads tacked down are realty; untacked rugs or carpets are personalty.

Laundry platform and attached clothes line on roof of property are realty.

An intercommunicating system is realty.

Gas stoves are personal property.

Hot water heater and tank is realty.

Fire hose is personalty while racks holding same are realty.

Elevators are realty.

In-a-door beds, if affixed to door or walls are realty, but if movable from room to room, are personalty.

Electric clocks are personalty.

Neon sign is realty. 7/9/53.

150.0278 **In-Place Sale of Machinery and Equipment.** A manufacturing company who leases a building and owns pieces of machinery attached to the leased realty sold its assets. If, under the term of the lease, the lessee may not remove the machinery and equipment at the end of the lease term and must leave those items for the lessor such that the lessor effectively owns those items, the machinery and equipment would be regarded as real estate. However, the fact that the lease allows for removal of the machinery (upon repair of any damage to the real property caused by the installation or removal of the machinery or equipment) precludes any claim of conversion to realty by virtue of permanent attachment. Accordingly, the sale in place of machinery and equipment would be subject to tax. The classification of property in Regulation 1521 is to be used as a guide in determining whether the property is ‘‘machinery and equipment’’. 1/3/91. (Am. 2000–2).

150.0290 **Lease of a Steam Generating Plant.** The sale of a steam generating plant which is a building or structure of a fixed work under Regulation 1521, when severance is not contemplated, is a sale of an interest in realty even though the land is not sold. Following the sale, the facility is leased. The facility does not lose its character as an improvement to realty under the lease contract. It is true that the facility incorporates within it items which would be classified as ‘‘fixtures’’ under Regulation 1521. Regulation 1596(c) applies to transfers of fixtures, but the lease contract involves the lease of a building, not merely the sale or lease of fixtures. Under Regulation 1660(d)(7), leased fixtures are classified as ‘‘tangible personal property’’ unless the lessor of the fixtures is also the lessor of the realty. Here the realty is the structure, and the fixtures in question are attached

to the realty. Under these circumstances, the lease is a lease of realty, not tangible personal property, and tax does not apply. 12/8/89.

150.0298 **Leased Premises—Sale of Machinery and Equipment.** Company A is the lessor to Company B of a building and of certain machinery and equipment installed therein. Pursuant to the lease agreement concerning the machinery and equipment, B was authorized to remove items of equipment (with title passing to B) provided equipment of equal value was substituted (with title passing to A) for the equipment removed.

The sale by A to B was sale of tangible personal property because removal of the property was contemplated at the time of the sale. Accordingly, the sale was a sale of tangible personal property notwithstanding the fact that the property was never classified as ''leased fixtures'' pursuant to section 6016.3 while in place and under lease. The property was not ''leased fixtures'' because the lessor of the property was also the lessor of the building. It appears that the sale of this property did not qualify as an ''occasional sale.''

The sale by B of the replacement property to A was also a sale of tangible personal property. The property in question appears to have been machinery and equipment. B sold the equipment to A and installed the equipment. This was a sale of tangible personal property to be installed and not a sale of property ''in place.'' The sale of the property by B to A was a taxable sale of tangible personal property notwithstanding the fact that the property never became ''leased fixtures'' under section 6016.3. 10/26/79.

150.0300 **Leased Premises—Sale of Machinery, Equipment and Fixtures Installed on.** Although a lessee is permitted or required to remove fixtures upon terminating an oil lease the transfer of casing, tubing, derricks, pipes, valves, fittings and other appurtenances attached or affixed to the property constitute fixtures and are nontaxable, providing they are transferred with a lease of indeterminate duration. 11/8/68.

150.0340 **Leased Premises—Sale of Machinery, Equipment and Fixtures Installed on.** Gross receipts from sale of machinery and equipment installed by a lessee on leased premises are taxable where the machinery and equipment are classified under the lease agreement as personal property which the lessee has the right to remove from the premises. The sale of the machinery and equipment to the buyer and the assignment of the lease by the lessee with the consent of the lessor give the buyer all the rights the lessee had under the lease, including ownership of machinery and equipment on the premises. 10/14/69.

150.0380 **Leased Premises—Sale of Machinery, Equipment and Fixtures Installed on.** The sale of affixed machinery and equipment by a lessee in connection with the sale of a leasehold to an assignee constitutes a taxable sale of personalty, when the lessee has the present right to remove the property, or when the fixtures are trade fixtures. The tax applies even if the assignee does not intend to sever the property. 6/21/55.

BUILDINGS, ETC. (Contd.)

150.0385 **Lessor and Lessee Sales of Fixtures.**

(1) The sale of a fixture by a lessee of realty to the lessor/owner is not taxable unless the contract of sale contemplates removal by either party.

(2) The sale of a fixture by a lessor/owner of realty to the lessee is not taxable unless the contract of sale contemplates removal by either party.

(3) The sale of a fixture by the lessee of realty to a successor lessee of the realty is taxable if both parties have the present right of removal or if the contract of sale contemplates removal by either party.

(4) The sale of a fixture by the lessor of a fixture to the lessee of the fixture is taxable as a sale of tangible personal property if the lessor has the right to remove the fixture on breach or termination of the lease and the lessor is not also the lessor of the realty. The transaction is also taxable if the contract of sale contemplates removal by either party. 3/18/75.

150.0386 **Lease of Land and Buildings.** A is the lessee of land and building and operates a bowling alley at the site. A purchased the business from B, the previous lessee of the site. The purchase included the liquor license, fixed assets, inventory, bowling lanes and equipment, office and bar furniture and equipment, stock in trade including resale merchandise and leasehold interest, etc. Pursuant to the lease agreement with the lessor C, B covenanted that ''the fixtures, furniture, and equipment listed above shall remain on the premises during the entire period covered by the present lease and its extensions, and that, as and when, any of the fixtures and equipment installed in or upon the demised premises shall become obsolete, lessee shall replace the same . . . .'' B claims that it did not have the present right to remove the fixtures at the time of their sale since it was obligated to maintain them on the site pursuant to the lease.

It is clear that the owner of the real property, C, regarded B as the owner of the fixtures and equipment. The fact that B has agreed to keep the property in place during the term of the lease does not negate a conclusion that B had the present right to remove the items within the meaning of Regulation 1596. The lessor's ''interest'' in the property arose not from the law concerning accession to real property but from B's contractual undertaking to have the items in place during the term of the lease. Under the lease agreement, B has undertaken to keep on the premises office furniture and equipment and other items in no way affixed to the real property. Clearly the sale of these items was subject to tax despite the undertaking of B not to remove them from the premises. This conclusion should not differ with respect to items which may have been affixed to the realty when the items constituted trade fixtures and were treated by the lessor and the lessee as property belonging to, and alienable by, the lessee. 8/20/76.

150.0395 **Oil Well Pumping Unit.** The in-place sale by an owner of the land of an oil well pumping unit whose parts are attached to realty by concrete, bolts, screws, etc., is not taxable when removal of the pumping unit is not contemplated by the contract of sale.

However, if some of the items of the unit such as the motor or pumping unit are not attached to the realty but rather resting in place solely by force or gravity, the sale of such items would be subject to sales tax. 6/3/88.

BUILDINGS, ETC. (Contd.)

150.0400 **Outdoor Advertising—Cutouts.** "Cutouts" are plywood embellishments attached to billboards to increase the advertising space. These consist of letters or forms on which are painted pictorial representations, are moved from one billboard to another, and junked at the end of a particular advertising campaign. If the billboard owner passes title to or the right of possession of the cutouts to the advertiser, tax applies to the charges for materials contained in the cutouts together with the charges for fabrication labor in manufacturing them. If title to or the right of possession of the cutouts does not pass to the advertiser, then the billboard owner is the consumer of the materials contained in the cutouts. 7/1/59; 7/11/90.

150.0420 **Outdoor Advertising—Signs.** The sales of advertising structures in place, whether erected on leased land or on property owned outright, constituting real property at the time of the sale are not subject to either State or local sales tax, but a sign affixed to a building in such a manner that it is readily removable as a unit is treated as personal property, if, at the time of the sale, the owner is a lessee of the building and has the present right of removing the sign. 5/23/60.

150.0460 **Portable Classrooms.** Portable classrooms are required by contracts of sale to be built at "depot" locations on a mass production basis. Unlike other portable classrooms placed on permanent foundations similar to those of houses, the foundations of the portable classrooms under the contracts are designed to support the classrooms during construction only. Completed structures are removed from the depot side by the school district to the classroom site. Because of lack of permanency of the foundations and of the school district's responsibility to remove the finished classrooms, the contracts are classified as contracts for the sale of tangible personal property rather than contracts to improve real property, and if a sufficient number of sales are made, are taxable sales of personal property. 11/17/69.

150.0505 **Relocatable Classrooms.** After a relocatable classroom is affixed to land it is considered real property. The sale of relocatable classroom buildings in-place while subject to a pending lease is not a sale of tangible personal property unless the seller-lessor intends to sever those buildings from the land. 8/21/90.

150.0520 **Removal of a House.** If a buyer purchases a house or other structure affixed to land for removal by him, but prior to removal resells it to a third party pursuant to an agreement which provides that the third party or someone hired by him is to remove the structure from the land, the buyer's sale of the house or other structure to the third party is a sale of real property since at the time of his sale the structure is still affixed to the land. 9/10/69.

150.0528 **Removal of Sand from Land by Lessee.** When a lessee is granted permission to sell river sand, no sales tax is involved between the lessor and the lessee. However, if the lessee removes the sand and sells it, the lessee is making a sale of tangible personal property and the sale is subject to tax.

If the lessee grants an option to a contractor pursuant to which the contractor will provide excavating, transporting equipment, and digging the sand from the

river bottom, and if the lessee sells sand, the gross receipts of the lessee will be subject to the tax. However, if the lessee merely assigns his right to remove sand, the removal of the sand by the assignee would be in the same status as removal of the sand by the lessee, and the tax would not apply. 1/24/62.

150.0535 **Right of Removal.** Company A owns and operates a plant which produces and circulates heated and chilled water to a hotel. The plant is on land owned by the hotel. The contract between A and the hotel runs for 25 years and the hotel has the option of extending for five terms of five years each. The hotel also has the right to purchase the plant at the expiration of the original 25 year term.

The plant was sold in place by A to Company B. A continued to operate the plant.

The sale of the plant constituted a sale of realty. The affixed property was sold in place. Neither A nor B contemplated removal of the property, and neither person had any present right of removal of the property either by the express terms of the lease agreement or by operation of law. 4/4/72.

150.0540 **Right to Remove** from realty, sale or grant of, does not constitute a sale of personalty and charge made for right is not taxable. 4/11/50.

150.0550 **Rock, Sand and Gravel Affixed to Realty.** In general the retail sale of rock, sand and gravel, previously removed from the ground, is subject to tax. However, the sale of rock, sand or gravel in place is not a sale of tangible personal property. Therefore, where the owner of the land severs the material himself and consumes it in fulfilling a construction contract, or where the owner grants the right to another to remove the rock, sand and gravel from the ground, the transaction is not subject to the sales tax. 4/11/50.

150.0551 **Sale of Central Cooling and Ice Storage Facility.** The sale, in place, of a central cooling and ice storage facility (part of the cooling system), is exempt from the sales tax when there is no contemplation that either the seller or buyer will remove the facility, or any portion of the facility, from the realty. The only tax due is the tax paid at the time of construction. 4/23/91

150.0552 **Sale of a Gasoline Service Station.** The assets of a gasoline service station being sold consist of underground storage tanks, pumps and canopies. The pumps are mounted to a concrete ‘‘island’’ and the canopies are mounted to vertical pipes which are imbedded in the earth. Tax applies as follows:

If the seller owns both the land and the pumps, tanks and canopies, the sale of the tanks and canopies is not taxable unless the contract provides that the seller will sever these items. With respect to the pumps, if the contract provides that the pumps are to be removed by either the seller or the purchaser, the gross receipts from the sale of the pumps are taxable. Otherwise, the sale of the pumps is not taxable.

A different rule applies to the pumps if the seller is leasing the land. Since pumps are trade fixtures under section 1019 of the Civil Code, which gives the seller-lessee the right to remove the pumps, the sale of the pumps under these circumstances is taxable. 7/24/91.

BUILDINGS, ETC. (Contd.)

150.0560 **Swimming Pools.** Sales of prefabricated aluminum swimming pools installed by the seller above ground on a base of sand are retail sales of tangible personal property. The price for on-site assembly and fabrication is included in the gross receipts although the price for services used in installing the pools is excludable. 8/9/68.

150.0580 **Standing Timber.** A contract to sell standing timber in which the purchaser is required to sever such timber at a given price per unit is regarded as a sale of personal property. If, however, purchaser is merely granted an option to sever the timber and is not required to make the severance, the contract is for the sale of an interest in realty not subject to sales tax.

If contract is for the sale of personal property and the purchaser proposes to cut the timber and sell it to a lumber mill, the sale would be exempt as a sale for resale. 12/31/53.

150.0620 **Transfer of Building in Place.** The transfer (sale) of land to one entity and the building to another entity does not result in a sale of tangible personal property when the building is affixed to the land. The transfer of the building is treated as a sale of personal property and taxable only when the building is to be physically severed by the seller at the time of the sale. If the building is to be severed by the purchaser at the time of the sale, it is real property and the sale is not subject to tax. 9/7/93.

150.0628 **Transfer in Place of Concrete Batch Plants.** Where concrete batch plants are located on leased property and the lease states that the batch plants are to remain the property of the lessee and the lessee would remove them at the end of the lease, the batch plants are considered tangible personal property. Thus, the sale is subject to tax even though removal is not contemplated. See *Standard Oil Co.* v. *State Board of Equalization,* 232 Cal.App.2d 91. 3/24/92.

150.0680 **Water Meters.** A sale of water meters in place as part of the sale of a private water system is a sale of tangible personal property when the meters are on land not owned by the seller, and subject to tax. 9/26/56.

150.0700 **Water Meters.** Sales of water meters in place are sales of real property and not subject to tax unless the seller is the lessee of the premises having the right to remove the meters and sells them to a purchaser who likewise has the right to remove the meters from real property owned by others. 1/27/65.

BULLION

See Coins and Bullion.

BUSINESS REORGANIZATION

See Occasional Sales—Sale of a Business—Business Reorganization.